

**Final Public Report
Focused Audit of Affiliated Transactions
and Management Audit
of the South Jersey Gas Company**

Volume Three: EDECA Affiliate Standards

**Public Version
(SHADED MATERIALS ARE CONFIDENTIAL)**

Presented to the:

**Division of Audits
New Jersey Board of Public Utilities**

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I. Background

A. Introduction

This chapter of Liberty's report describes the results of its audit of SJI/SJG performance under the affiliate standards (*Standards*) that the Board has adopted to enforce the New Jersey Electric Discount and Energy Competition Act, N.J.S.A. 48:3 -49 *et seq.* (*EDECA*). Liberty also conducted a detailed examination of cost allocation and assignment, which form a principal focus of EDECA. The report of that examination addresses the cost allocation and assignment portions of the Standards. The specific categories into which Liberty divided the audit work addressed by this report include:

- SJI's Retail Competitive Services
- General Administration of the Standards
- Employees Guidance and Training
- Non-Discrimination
- Information Disclosure
- Separation
- Follow-up From Prior EDECA Audit.

The Standards contemplate five principal types of entities:

- Electric or gas public utilities
- Retail competitive business segments of the electric or gas public utilities
- Public utility holding companies
- Retail competitive business segments of the public utility holding companies
- Service companies.

The principal components of the Standards fall into four main categories:

- Non-Discrimination (Section 14:4-5.3)
- Information Disclosure (Section 14:4-5.4)
- Separation (Section 14:4-5.5)
- Utility Retail Competitive Business Segment Standards (Section 14:4-5.6).

These four components do not apply to the same types of transactions. For example, the standards set forth in Sections 14:4-5.3, 14:4-5.4, and 14:4-5.5 apply to transactions between the utility, on the one hand, and its public utility holding company or a related competitive business segment (*RCBS*) of its public utility holding company that is offering or providing retail services to customers in New Jersey, on the other hand. These three components do not apply to transactions between a utility and an *RCBS* under its ownership, however. Conversely, the Section 14:4-5.6 standards do apply to transactions between a utility and its own *RCBS*; however, they do not apply to transactions between the utility and its public utility holding company or an *RCBS* of its public utility holding company. There is substantial overlap among the standards set forth in Sections 14:4-5.3, 14:4-5.4, and 14:4-5.5, however. Similarly, there is overlap among them and the Section 14:4-5.6 standards.

B. Summary of Audit Recommendations

ED-1. Treat SJE energy services, HVAC installations by SJESP, energy product development and plant management and operation by Marina, meter reading services by Millennium and air monitoring services by AirLogics as SJI holding company RCBSs for purposes of applying the standards.

ED-2. Cease the practice of deeming retail activities permissible because the BPU has not specifically declared them to be “competitive,” and make the change clear to employees through an immediate, supplemental communications program.

ED-3. Assign the Corporate Counsel or the Vice President of Rates and Regulatory Affairs as compliance director, with the responsibility for assuring senior executive management and the board of directors that Standards compliance planning is adequate, that there exist adequate controls to assure compliance, and that compliance is adequate in all material respects.

ED-4. Make regular analysis of the appropriateness of cost assignment and allocation among affiliates and the auditing of performance under the Standards a routine, ongoing part of compliance efforts.

ED-5. Provide brief, mid-cycle reminders to employees about Standards compliance.

ED-6. Correct training materials to conform to a more accurate and complete conception of what constitutes an RCBS.

ED-7. Provide compliance guidance and training to RCBS employees and their contractors and partners.

ED-8. Cease promotion of SJG/SJE joint community programs associated with Customer Choice or other RCBS offerings and add the Section 14.4-5.5(k) disclaimer to the pages of the SJE web site that address customer choice.

ED-9. Incorporate into the Compliance Plan specific methods, location, and timing for the posting of the availability of services to other market participants.

ED-10. Given the historical lack of sound definition of and control over prohibited activities, incorporate into the Compliance Plan and into guidance and training (including that for RCBSs) a comprehensive discussion of what transaction types the Standards prohibit.

ED-11. Provide all marketers with updates of billing and receivables services provided, including rates, and make further updates when changes occur, but not less frequently than every other year.

ED-12. Provide greater detail in transaction posting.

ED-13. Change the Compliance Plan to require the involvement of the rates and regulatory affairs department in processing affiliate service requests in a manner similar to its role with respect to other provisions related to tariffed services to affiliates.

ED-14. Change the Compliance Plan to require the involvement of the rates and regulatory affairs department in customer assignments in a manner similar to its role with respect to Standards' provisions related to tariffed services to affiliates.

ED-15. Reassess and expand the definition of what constitutes enrollment, marketing, and development assistance to affiliates, and substantially improve controls over its provision.

ED-16. Provide supplemental guidance on the bonus program for SJG employees who handle overflow SJESP telephone contacts.

ED-17. Revise customer-care procedures either to prohibit the provision of advice about an RCBS or, alternatively, to provide a narrative description making clear to employees the occasions on which advice can be offered to customers about affiliates; if such advice is to be permitted, the plan must also specify how employees are to make similar advice available regarding other market participants.

ED-18. Provide a more comprehensive description of what constitutes *customer-proprietary* information subject to protection under Section 14:4-5.4(a).

ED-19. Instruct contractors involved in creating, operating, or supporting systems containing customer-specific information of the need for preserving separation of access by affiliates.

ED-20. Provide a more comprehensive description of what constitutes *other non-public* information subject to protection under Section 14:4-5.4(b).

ED-21. Amend the operating procedures to include a prohibition on providing affiliates with information about unaffiliated energy marketers.

ED-22. Improve the work-request procedure for database access by requiring data-protection certifications.

ED-23. Structurally separate the marketing and sales functions of SJG and its RCBSs.

ED-24. Mandate that disclaimer required under Section 14.4-5.5(k) of the Standards be made on all materials circulated in New Jersey from any RCBS and related to marketing or sales.

ED-25. Make the disclaimer required under Section 14.4-5.5(k) of the Standards on the opening page of the website of each RCBS, and on any other page mentioning SJG or the provision of utility service offerings in New Jersey.

ED-26. Prepare and submit to the Board a report describing the stock materials where RCBSs use the disclaimer required under Section 14.4-5.5(k) of the Standards, and, when it is not used, its reasoning as to why it is omitted.

ED-27. End the use of SJI entity outings or similar entertainment or charitable events that include customers of both SJG and RCBSs.

ED-28. Eliminate the reporting of the SJRG vice president to the person he replaced.

ED-29. Assure timelier reporting of employee transfers to the BPU, and provide a link that enables the location of transfer postings.

ED-30. Include in job postings, where applicable, a notice of the need for preservation of the confidentiality of protected information.

ED-31. Prepare appraisals of market costs and calculations of book costs contemporaneously with the lease or sale of assets and record the correct cost at the time of transfer.

ED-32. Either reconcile rental costs charged to actual costs incurred after the fact, or use a reasonable factor to inflate dated costs to account for cost increases between the period use to determine rental charges and the period during which those rents are charged.

ED-33. Charge all entities, including SJG, for unusable, empty, and common space in proportion to their use of rentable space net of components such as these.

ED-34. Include investment costs in charges to affiliates for occupancy of premises for which SJG pays.

ED-35. Include an appropriate loader for rent in the labor costs of employees whose time is directly charged or allocated to another affiliate.

II. SJI's Retail Competitive Services

A. Background

SJI is a holding company that is exempt under the Public Utility Holding Company Act of 1935. It is a New Jersey corporation. SJI now has six major subsidiaries:

- South Jersey Gas Company (*SJG*): the local-distribution public-utility company, of which it owns all the outstanding common stock
- South Jersey Resources Group, LLC, (*SJRG*): started in 1996 and sells natural gas at wholesale and natural-gas related services to utilities and marketers of fuel
- South Jersey Energy Company (*SJE*): organized in 1973 and sells natural gas and electricity and energy-market services to end-users; *i.e.*, at retail
- SJE also holds SJI's half ownership interest in AirLogics, LLC (*AirLogics*), a joint venture with GZA GeoEnvironmental, Inc. AirLogics formed in 2000 as a Delaware corporation and providing environmental monitoring devices and services associated primarily with site remediation activities
- South Jersey Energy Service Plus, LLC (*SJESP*): formed in 2004 as a wholly-owned SJI subsidiary (formerly South Jersey Gas Service Plus, LLC), and providing and servicing gas-using appliances for consumers (prior to August 2004, the SJG operated service portion of the business)
- Marina Energy LLC (*Marina*): formed in 2000 and developing, owning, and operating projects that supply thermal and electrical energy to large commercial and industrial end-users
- Millennium Account Services, LLC (*Millennium* or *MAS*): formed in 1999 as a joint venture with Conectiv Solutions, LLC (owned by Pepco Holdings) and providing meter-reading services in southern New Jersey to Atlantic City Electric and SJG, the two largest utilities in the area.

Discontinued SJI businesses comprised a minimal part of the corporation's activities in recent years. SJI's cumulative loss from these operations in the period 1999-2003 was less than \$3 million. As will be shown below, the discontinued businesses still receive support from SJI's and SJG's service functions. These businesses include:

- SJI EnerTrade, Inc. and South Jersey Energy Solutions, LLC, which SJE owns
- R&T Group, Inc.
- Energy & Minerals, Inc. (EMI)
- South Jersey Fuel, Inc., which EMI owns.

The identification of the affiliates covered by the Standards comprises an important baseline element in assessing compliance. Liberty has found wide variation in how New Jersey holding companies determine which affiliates are subject to the Standards. Liberty's first effort in this portion of its examination of SJI/SJG was to determine how they made such decisions.

B. Findings

SJI provided a list of products and service provided by each SJI business:

SJG

- Retail gas sales
- Emergency heater repair service
- Relocation of utility facilities
- Other tariff-related services

SJE

- Retail gas and electricity sales
- Energy services

SJESP

- Heating and cooling system installation
- Appliance service

Marina

- Energy project development
- Energy plant management and operation

SJR

- Wholesale gas sales

Millennium

- Meter reading services

Airlogics

- Air monitoring services

SJG has not segregated its utility revenues to allow identification of the revenues earned from relocations and from other tariffed services separately. The provision of emergency heater repair service, authorized in connection with the transfer of the appliance-service business in September 2004, has earned no revenues, because there have been no customer requests for that service.

SJG considered appliance services to be the only competitive service that the utility provided during the audit period. SJESP began its appliance-service business beginning in September of 2004, after SJG transferred the business to the affiliate, following BPU review and approval. SJESP existed and operated before September 2004. It had been performing heating and air conditioning installations for customers since its inception in June 2003. Through August of 2004, SJESP had completed approximately 625 installations.

SGJ therefore has no recognized RCBS now. SJI listed only three retail competitive services provided by affiliates during the audit period:

- Retail gas sales by SJE
- Appliance services initiated on September 1, 2004 by SJESP, which it acquired, after a July 26, 2004 approval of the BPU, from SJG
- Emergency heater repairs by SJG, which will continue until July 2006, as part of a transition period ordered by the BPU in connection with the transfer of SJG's appliance service business to SJESP.

The Company indicates that the last service will be provided under the BPU's July 26, 2004 Order for a transition period ending in July 2006.

Liberty addressed with SJI its basis for determining how to classify the product and service offerings of its affiliates. The Company takes the position that the products and services of its affiliates fall under the Standards as *competitive* only in two alternative cases:

- Where the affiliate offers products and services in competition with those offered by SJG
- Where the BPU has otherwise declared a product or service offered by an affiliate to be competitive, whether or not SJG offers them to retail customers in New Jersey as well.

According to this means of classification, the services offered by Millennium are not competitive, because the utility does not offer them in competition with SJG and the BPU has not declared the services offered by Millennium to be competitive. According to the Company, SJESP's appliance services do qualify as retail competitive services under the Standards, even though SJG does not offer them in competition, because the BPU has declared them competitive.

The AirLogics business plan describes this entity as a partnership between SJE and GZE Geoenvironmental, Inc. The partnership began in 2000, seeking to market a patented air-monitoring system. A four person executive committee manages the AirLogics business. The partners each provide two persons for this committee. By mid-2004, AirLogics served a number of utilities operating remediation sites, and planned to market services to other utility and non-utility customers. AirLogics provides monitoring equipment and related services to those utilities.

C. Conclusions

a. The application of the "in-competition with the utility" rule misconstrues the intent of EDECA and the Standards.

The Standards have the clear intent of protecting third-party competitors against showing affiliates and subsidies forms of favoritism that arise from utility operations and relationships with customers. The effectiveness of the Standards in meeting this goal would substantially diminish under the Company's interpretation. It would make the application of the protections effective only where a holding company chose to make the same products and services available both through utility and non-utility affiliates. A holding company could make it lawful to use utility operations to favor or subsidize a non-utility affiliate simply by discontinuing or never initiating similar services through its utility. No language in the Standards supports such a distinction. That lack, and the fact that the Company's interpretation would allow facile frustration of the central purposes of the Standards, makes the Company's interpretation inappropriate.

b. Retail competitive business segments of SJI provided during the audit period a number of retail competitive services that the company failed to acknowledge as such.

These services include:

- Energy services provided by SJE
- Heating and cooling system installation provided by SJESP

- New energy product development by Marina associated with the provision of cooling, heating, hot water, and electricity to the extent not intended for resale by customers of Marina
- Management and operation of existing energy plants by Marina for customers to the extent that those customers do not engage in the resale to others of the cooling, heating, hot water, and electricity produced by those plants
- Meter reading services by Millennium
- Air monitoring services by AirLogics.

All of these services consist of retail services in markets where third parties compete to serve similar end users. See Liberty's March 31, 2003 *Final Report- ACE Competitive Services Audit*; Docket No. EA02020095. That report contains a detailed discussion of Millennium's status as an RCBS of Conectiv and it provides Liberty's rationale for determining that Millennium was an RCBS.

D. Recommendations

1. **Treat SJE energy services, HVAC installations by SJESP, energy product development and plant management and operation by Marina, meter reading services by Millennium and air monitoring services by AirLogics as SJI holding company RCBSs for purposes of applying the standards.**

SJI does not agree that the SJE, SJESP, Millennium, and AirLogics services fall within the definition of retail competitive business services. However, the Company does recognize the need to avoid cross subsidization by SJG, and it wishes not to continue controversy surrounding their status. SJI therefore, while not agreeing to Liberty's definition of what constitutes RCBS, does agree to the treatment of businesses operated by SJE, SJESP, Millennium, and AirLogics as within the scope of the EDECA standards.

SJI, however, raises a significant concern about the treatment of Marina and other potential new operations as RCBSs merely because they make retail sales in New Jersey. Liberty continues to believe that Marina is an RCBS. The services it provides are not provided to persons who resell them to others. Marina's customers are *retail* in the same sense as are the large industrial customers to whom SJG provides natural gas transportation or commodity. Nevertheless, SJI makes what Liberty considers to be an important point in noting that it would be problematic for it to separate senior executives, such as the CEO, from the operation of new non-utility enterprises, because of the need for cost and risk oversight, for example.

Particularly for a smaller company like SJI, it would be very expensive to create management structures that separate utility and non-utility structures at all levels below the CEO of the holding company. It should be expected that the individual in charge of SJG will remain for an indefinite period of time as the CEO of SJI as well. There is good reason to provide for common oversight of SJG and non-utility operations like those of Marina. The same holds true for the CFO and the general counsel and for the same reasons; *i.e.*, creating wholly separate organizations in these areas is not only cost ineffective, it more importantly has the potential for

removing a useful source of insight over non-utility businesses by persons with a strong utility focus.

The same argument could be made at many other levels and functions. Accepting those arguments would substantially undercut the separation requirements of the standards. Liberty does not endorse that broad approach, but does see merit in allowing utility CEO, CFO, and general counsel *crossover* on a showing that it will provide, from the utility perspective, a useful form of oversight and control of business risk. Therefore, the Board may find merit in considering the making of an exception (for these three positions) to the EDECA requirements provided that the Company can make a prior showing of such usefulness to the utility, and further provided that the exception be for a reasonably limited period of time early in the development of such new enterprises. Liberty believes that the separation goals of the standards would not be unduly compromised under these limited conditions.

- 2. Cease the practice of deeming retail activities permissible because the BPU has not specifically declared them to be "competitive," and make the change clear to employees through an immediate, supplemental communications program.**

III. General Administration of the Standards

This section of Liberty's report addresses how SJI/SJG generally administer the Standards. SJI's non-utility operations have become substantial, and continue to grow. Sound administration of the standards therefore requires now a formal approach, a focus on training and communication, and the dedication of resources sufficient to assuring a proper environment for assuring compliance with the Standards.

A. Findings

Corporate counsel has general responsibility for ensuring compliance with the Standards. Four departments have functional responsibility for assuring compliance:

- Rates and Regulatory Affairs
- Accounting
- Gas Supply
- Corporate Counsel

The Manager, Regulatory Affairs takes primary responsibility for preparing and implementing the Compliance Plan.

SJG is the SJI entity that has primary responsibility for CAM maintenance. Specific responsibility for updating the CAM is divided among:

- SJG Controller
- SJI Manager of Financial Reporting
- SJI and SJG Executive Vice President and CAO
- SJG Benefits Manager
- SJG Manager, Fleet & Storeroom Operations
- SJG Insurance & Claims Supervisor
- SJG Information Systems Vice President
- SJG Customer Services Vice President.

SJI/SJG did not conduct structured analyses of the appropriateness of cost assignment and allocation among affiliates during the audit period. SJI/SJG has not in the last three years performed any audits to assure compliance with the standards. SJI/SJG do not prepare any routine reports providing management with summary information about the level of services and charges being made among affiliates.

The only complaints that SJI/SJG received from competitors about competitive services related the promotions related to heater conversions. Liberty addresses those complaints later in Chapter V.M. of this report, which addresses Section 14:4-5.3(m) of the Standards.

B. Conclusions

- SJI and SJG appropriately involve in compliance administration the full range of work groups whose day-to-day work the Standards affect.**

These groups take responsibility for Standards compliance and work under a common plan to provide training and communication to support it.

b. Ultimate responsibility for establishing a consistent interpretation and approach to compliance and for assuring it is not sufficiently centralized.

The loose coordination of these responsibilities typifies an enterprise with a low level and simple structure of non-utility activity. SJI's non-utility businesses no longer fit this model, given their growth in the past several years. Liberty has observed a number of occasions on which operating personnel have not interpreted requirements properly and on which compliance has been inconsistently achieved. Non-utility operations at SJI have reached the point at which someone senior should have clear and consolidated responsibility for providing assurances to senior executive management and the board of directors that compliance is comprehensive, regular, and not subject to significant exceptions.

The person to be given this responsibility should not have significant direct responsibilities for the business operations affected substantially by the Standards, in order to mitigate the conflict between pressures to comply and pressures to meet business performance targets whose attainment might be benefited by loose interpretations, if not violations, of the Standards.

The lack of examination of key elements of the Standards by Internal Audit and the dispersal of responsibility for CAM maintenance also no longer comport with the size and complexity of non-utility operations.

C. Recommendations

3. Assign the Corporate Counsel or the Vice President of Rates and Regulatory Affairs as compliance director, with the responsibility for assuring senior executive management and the board of directors that Standards compliance planning is adequate, that there exist adequate controls to assure compliance, and that compliance is adequate in all material respects.

It remains appropriate for the Company to involve the broad range of groups and people it now uses as part of its compliance planning, execution, and monitoring. There should be, however, a single person to whom senior executive management and the board hold responsible for these matters. The job description, expectations, evaluation, and rewards for this person should in significant address and relate to success in performing these roles. The person assigned this role will probably require help and assistance from the other groups and people now involved. The use of a committee or task force structure for providing that assistance should mean that there will be no major increase in workload for the support group.

4. Make regular analysis of the appropriateness of cost assignment and allocation among affiliates and the auditing of performance under the Standards a routine, ongoing part of compliance efforts.

The compliance director should provide for regular planning and execution of analyses and audits of cost assignment and allocation and of other material elements of the Standards. This work should be planned in conjunction with of Internal Audit's yearly work planning cycle, in

order to take advantage of Internal Audit's risk assessment capabilities and to coordinate resources effectively. The compliance director should first address the results of the analyses and audits. Liberty would anticipate that the analytical and auditing effort should add (incrementally to what the Company now does in this area) up to but not more than the equivalent of one-half a person year on a recurring basis.

The compliance director should also be responsible for addressing complaints or concerns from customers or competitors about compliance with the Standards. Assuring compliance with the standards would be benefited by including on the SJI and SJG web sites the ability of customers and competitors to address complaints and concerns to SJI and SJG.

IV. Employee Guidance and Training

This section of Liberty's report addresses SJI/SJG's growing use of employee guidance and training to help them understand the rules, to stress the importance of meeting them, and to provide specific guidance in adhering to them.

A. Findings

SJG conducts every other year a series of refresher programs addressing employee obligations that must be met to satisfy the Standards. Liberty reviewed the 2004 program in order to assess its sufficiency and completeness in making employees aware of the requirements of the standards, of the specific actions and prohibitions that they must take to assure compliance, and of the importance that SJG attaches to remaining in compliance. Implementation of the 2004 refresher program began with a memorandum to the officers and key managers of SJG. The memorandum received a wide distribution. It went to the managers of SJG's customer service, sales, distribution operations, engineering, supply, sales, information services, regulatory affairs, controller, and property management functions, with copies to the executive team of the utility. This July 14, 2004 memorandum:

- Reminded them of the need for certain employee groups to attend refresher meetings and for others to receive memoranda
- Recited the need for distribution of handouts detailing accepted behaviors
- Noted the necessity of completing attendance lists to verify that the required training has been received
- Emphasized the need to complete all required sessions in August
- Listed the specific portions of the 2004 *Communications Plan* that would assist in providing the training.

Each of these managers also received copies of required attendance and distribution lists for the training sessions and materials, as well as the copies of the handouts. The Company issued an August 2, 2004 special edition of its newsletter, *SJI Today* in order to communicate to the general employee population the pendency and importance of refresher training,. This one-page edition offered employees a reminder about the need to comply with the Standards and a summary of 11 things employees can or cannot do or say under the Standards.

SJG has recently provided supplemental training information to its customer service and transportation groups. A procedure for the transportation group's use addressed how to maintain the list of third-party suppliers. A procedure for use by the Customer Care Center discussed the kinds of recommendations, endorsements, and information that can and cannot be provided under the Standards. This second procedure included a form requiring individual employees to certify receipt, understanding and agreement to comply with the procedure. All *Customer Care Center* employees completed the form in the Fall of 2004; SJG retained the completed forms.

The 2004 *Communications Plan* is a more than 50 page document that describes what instruction about the Standards is required, who needs to receive it, and what specific form that instruction must take. The plan focuses specifically on a subset of the Standards:

- 3-2(a); transactions
- 3-10 (a) and (b); business development and customer relations
- 4-1; customer information
- 4-3; supplier lists
- 4-4 (A) and (b); non-public supplier information
- 4-5 (A) and (b); product and service-provider information.

The plan also contains a brief summary of the background and purpose of the Standards, along with a discussion of the penalties that apply for non-compliance. A list of practical examples of what kinds of communications are permitted and prohibited follows. It contains one example allowing an SJG customer representative to recommend to a customer the use of SJE for lighting retrofits, "because lighting retrofitting has not been declared a competitive service by the NJBPU." The information encourages employees to resolve doubts about what they can communicate through discussions with a supervisor. The second half of the plan consists of a list of individuals who must receive training sessions or memoranda. SJI does not provide any routine communications about the Standards to supplement the biennial training.

SJE does not provide any structured training to its employees about the standards. SJE employees receive only an annual company newsletter reminder (last provided in August 2004) about the BPU standards. That newsletter contains only prohibitions on SJG employees, with no guidance or admonitions to SJE employees. The Company also provided the materials that SJE offers to contractors who solicit SJG residential customers to take services from SJE. Those guidelines note that SJE is not the same company as SJG, but provided no instruction on disclaiming any connection or tying between the two. The guidance did emphasize the fact that SJE is a "sister" company of SJG and that SJG would continue to provide all other important services.

B. Conclusions

a. SJG provides a focused and reasonably comprehensive approach to training utility employees in Standards compliance.

The training materials are comprehensive, focus on key Standards provisions that relate to everyday employee performance, and provide specific guidance. All utility employees affected by the Standards get training that tells them how the Standards affect their work performance and what they need to do to comply.

b. The cycle of training provided is adequate to cover new employees and to refresh the training of incumbents, but would be benefited by brief, mid-cycle reminders.

The Company reasonably assures that all employees get timely training. Its use of a regular cycle constitutes a particular strength. The program would be enhanced by a brief refresher in the off-year of the two-year cycle used.

c. SJG's misapprehension of the Standards has caused its training to promote certain communications that the Standards prohibit.

One example is the specific communication that would allow SJG employees to recommend SJE as a source of lighting retrofits, because the BPU has not declared such retrofits to be a *competitive service*. There clearly exists a competitive marketplace for this service, just as there exists one for the gas supply services that SJE offers. It is clearly not appropriate for SJG to instruct employees that the Standards do or do not apply on the basis of what services the BPU has declared to be *competitive*. Section I.D. of this report addresses Liberty's conclusion that SJG misapprehends the scope of the Standards. Guidance like this to employees appears to be a function of that SJG view of the Standards.

d. SJE does not provide adequate training or communications to its employees about the standards.

Compliance with the Standards takes the understanding and cooperation of the utility as well as the RCBSs, along with the employees of each. Training should not be limited to utility employees. The reasonably comprehensive training that SJG employees get helps to instill in them the value of compliance and to tell them specifically what types of conduct or statements to avoid. Corresponding training for SJE employees would provide similar benefits. See Section V.B. of this report, which provides an example of the kinds of problems that can result from the failure of RCBSs to provide sufficient guidance and training concerning the Standards. The portion of the report addresses Section 14:4-5.3(b) (*Prohibited Transactions*) of the standards.

e. SJE guidance to contractors who contact residential SJG customers emphasizes the connection with SJG, without disclaiming the need for or value of that connection.

What SJE should not do, those it contracts with to act on its behalf should not do either. SJE fails to inform its resources adequately about the requirements of the Standards and about the importance of assuring that those contractors act in accord with SJI-wide policies, procedures, and constraints involving the Standards.

C. Recommendations

5. Provide brief, mid-cycle reminders to employees about Standards compliance.

The goal of this recommendation is not to provide further training, but to assure at least yearly reminders of the importance of compliance and the need for attention to details in daily work performance. Beyond this, this reminder need do no more than refer to the training and materials provided every two years and to the available documentation that contains further details, should employees decide that they need to refer to them as refreshers.

6. Correct training materials to conform to a more accurate and complete conception of what constitutes an RCBS.

This recommendation consists of examining training materials for the purpose of removing guidance that relies upon an incorrect interpretation of what constitutes an RCBS. It also includes making a clear and specific list of the entities and services covered, in order to remove all ambiguity. That list should be provided and emphasized as part of the training program, and updated specially and timely in the event that SJI subsidiaries add new or changed service or product offerings.

7. Provide compliance guidance and training to RCBS employees and their contractors and partners.

In order to be fully effective, SJI's commitment to compliance must extend to the employees of its RCBSs. In particular, but not necessarily exclusively, this extension must include SJE, whose operations have a broad reach and extend to the mass markets. SJE is also an example of an RCBS that relies upon contractors for customer contact and outreach functions; *e.g.*, as a contracted telemarketing arm. SJI needs to assure that SJE, and any other RCBS conducting activities affected by the standards, develop at least summary programs and guidelines to control performance.

V. Non-Discrimination Standards (Section 14:4-5.3)

Section 14:4-5.3 of the Standards applies to interactions between a utility and an RCBS of its holding company or the holding company itself if it offers or provides competitive services to retail customers in New Jersey. These standards do not apply, however, in cases where an internal RCBS exists within the utility itself and where there are transactions between the utility and such an RCBS. Separate standards, which Chapter V of this report addresses, apply to interactions between utilities and their internal RCBSs.

A. Affiliate Preferences

1. Statement of Applicable Requirements

Section 14:4-5.3(a) of the Standards provides that:

An electric and/or gas public utility shall not unreasonably discriminate against any competitor in favor of its affiliates(s) or related competitive business segment:

- 1. An electric or gas public utility shall not represent that, as a result of the relationship with the electric and or gas public utility or for any other reason, a related competitive business segment of its public utility holding company, or customers of a related competitive business segment of its public utility holding company will receive any different treatment by the electric and/or gas public utility than the treatment the electric and/or gas public utility provides to other, unaffiliated companies or their customers; and*
- 2. An electric or gas public utility shall not provide a related competitive business segment of its public utility holding company, or customers of a related competitive business segment of its public utility holding company, any preference (including, but not limited to, terms and conditions, pricing, or timing) over non-affiliated suppliers of their customers in the provision of products and/or services offered by the electric and/or gas public utility.*

2. Summary of Audit Activities

This standard set forth in Section 5.3(a) and many of the standards that follow it address the issue of discrimination. Those that follow tend to apply to specifically designated cases (see for example the requirements of Section 5.3(c), which later sections of this report address, while this subsection (a) sets forth two, more general rules. Specifically, this subsection of the Standards prohibits two specific forms of favoritism to affiliates:

- Making representations that any RCBS of its holding company or that any customers of such an RCBS will be treated differently by the utility

- Providing preferences to any RCBS of its holding company or RCBS customers with respect to terms, conditions, pricing, timing, or other aspects of utility services.

Liberty's examination of discrimination under this subsection included the application of the following criteria:

- Whether the general paths used for regular customer communications make any direct or implied representations that selection of an RCBS would bring advantage to the customer in terms of utility service
- Whether the utility web-site makes any direct or implied representations that selection of an RCBS would bring advantage to the customer in terms of utility service
- Whether the utility compliance plan adequately addresses the requirements of this subsection.

Liberty identified what regular communications channels the utility used to communicate with customers during the audit period, and then gathered documents displaying the substance of those communications in order to examine them for evidence of prohibited discrimination. Liberty also reviewed the compliance plan to determine what standards of conduct it imposed with respect to employee representations to customers. Liberty examined the websites of the holding company, utility, and affiliates.

3. Findings

In October and November of 2002, SJI ran a 30-second corporate image spot 48 times on local television. The total cost of running the spots was about \$5,500. The ads did not mention any particular services. They ended with a shot of the names of SJI, SJE, and SJG shown together, with SJE on the top, SJI in the center, and SJG on the bottom. The ad contained no disclaimers. These were the only audit period television advertisements run by any SJI entity.

Parker and Partners developed print advertisements for SJI during the audit period. The following table summarizes these advertisements. The affiliates often use the same slogan: *Where we put all of our energy*. The following table summarizes audit-period print advertising.

Table V-1. Print Advertising Programs

Entity	Description	Period	Disclaimer	Cost
SJG	Air Conditioner Conversion/Incentives	May-Jun 2002	Not App.	\$38,000
SJG	Heater Conversion/Incentives**	Aug-Nov 2002	Not App.	101,200
SJG	Air Conditioner Conversion/Incentives	April/May 2003	Not App.	2,500
SJG	Heater Conversion*	April 2004	Not App.	2,600
SJG	Energy Star Homes	Apr-May 2004	Not App.	27,200
SJG	Medford Flood; Conversion/Replacement*	July 2004	Not App.	2,200
SJG	Image: Healthcare Support	Aug 2004	Not App.	1,300
SJESP	Air Conditioning Sales & Installation*	May/Jun 2004	Yes	17,600
SJG	Clean Energy Conversions/Incentives	Mar-Jun 2004	Not App.	73,300
SJESP	Appliance Installation & Repair*	Sep 2004	Yes	14,600
SJG	Natural Gas Conversions/Incentives*	Oct 2004	Not App.	3,800

* Reference to SJI website

The 2002 air conditioner and heater conversion advertising program provided references to the SJG, not the SJI website, and it listed the preferred contractors, none of whom was an affiliate, by name.

SJE and SJR did no print, radio, or television advertisements during the audit period. None of the print advertising used during the audit period, including but not limited to bill inserts suggested any form of preference for SJG customers who select an RCBS.

Web users enter all affiliate sites through the SJI webpage. That site contains the logo and the SJI-wide slogan. The home page for SJI contains links for the following affiliates:

- SJG
- SJE
- SJR
- SJESP
- Marina
- AirLogics

Liberty observed the following from examining the web page:

- No disclaimers appear anywhere on any page of the SJI website or in any of the affiliate links.
- The employment buttons of those affiliates link back to positions at other SJI entities, using an SJG contact address.
- In promoting a fundraising effort tied to taking service from SJE, the SJE portion of the web-site contains a statement that, "In New Jersey, as a result of deregulation, residential gas customers can now choose their natural gas supplier. South Jersey Energy (SJE), an affiliate of South Jersey Gas (SJG), is the state's leading energy marketer. They developed the 'Community Rewards Program' to save SJG customers money and to help nonprofit organizations raise much-needed funds."
- The SJE portion of the website states that, "switching to SJE won't affect your gas service. SJG will continue to deliver the gas safely and reliably."
- The SJE portion of the web-site further says that "Customers receive only one monthly bill from South Jersey Gas Co."

The Compliance Plan simply restates the language of this provision of the Standards, and refers to supplemental information provided to supervisory employees. It also includes a customer care operating procedure that prohibits providing leads or soliciting business for its retail competitive business services, prohibits any indication of preferential treatment if SJG customers do business with an RCBS, and cautions against representing that an RCBS speaks for SJG..

4. Conclusions

- a. **SJG did not during the audit period represent in its print or television ads or in any other written customer communications that its PUHC RCBS or the customers of the PUHC RCBS would receive any type of preferential treatment.**

b. The SJI web site creates a general implication of preference.

The SJE portion that discusses the selection of SJE as a supplier indicates a joint charitable effort between SJG and SJE, and could support a customer inference that selection of SJE, as opposed to other marketers, causes SJG to perform charitable service. This portion of the web site also allows implies that SJG has entered into a joint giving program with SJE and not other marketers. The SJE web sites make statements about continuing service and single monthly billing from SJG. This connection implies preferential treatment in the absence of the disclaimer required by Section 14.4-5.5(k) of the Standards.

c. The SJG Compliance Plan contains a prohibition against the two forms of conduct proscribed by this provision of the Standards.

The compliance plan adequately addresses this provision.

d. Liberty found no evidence of preferential treatment by the utility in favor of any PUHC RCBS or customers of the PUHC RCBS.

Liberty's examination of SJG conduct during the audit period disclosed no evidence of actual favoritism toward an RCBS.

5. Recommendations

- 8. Cease promotion of SJG/SJE joint community programs associated with Customer Choice or other RCBS offerings and add the Section 14.4-5.5(k) disclaimer to the pages of the SJE web site that address customer choice.**

B. Prohibited Transactions

1. Statement of Applicable Requirements

Section 14:4-5.3(b) of the Standards provides that:

Transactions between an electric and/or gas public utility and a related competitive business segment of its public utility holding company shall be prohibited, except for the following...

Subsection (b) then goes on to list the following exceptions to the prohibition on transactions:

- Tariffed products or services
- Sales and purchases made generally available to all market participants through open and competitive bidding
- Joint purchases allowed by Sections 14:4-5.5(g) and (h)
- Corporate support allowed by Sections 14:4-5.5(i) and (j)
- Competitive products or services offered by an RCBS within the utility, as allowed by Sections 14:4-5.6(a) through (f).

2. Summary of Audit Activities

The effect of this section is to prohibit a utility and an RCBS of its holding company from engaging in any form of transaction not specifically authorized by the Standards. The first, second, and fifth exceptions have in common the fact that transactions generally available to all comers, whether affiliated or not, are acceptable to the extent that they are governed by standard or uniform prices, terms, and conditions. The third and fourth exceptions recognize the right to use internal economies of scale or scope to provide an affiliate with services that are not made available to outsiders. Liberty's examination of this standard focused on whether non-tariffed transactions (except for permitted common services for purchasing and corporate support) were made available to all market participants. Pricing questions were not examined here, but under Sections 5.3(f) through (i), which cover discounts, charge waivers, and strict tariff enforcement in transactions between the utility and a holding company RCBS. Therefore, the criterion that Liberty applied here was:

- Whether the utility made available to a holding company RCBS opportunities to purchase or sell goods or services (apart from the allowed common purchasing and support service) not also made available to other market participants.

Liberty's audit included efforts to identify the flow of goods and services between the utility and its affiliates. Liberty examined the transaction information provided by the utility for compliance with this criterion. Liberty supplemented these efforts by questioning the utility as to its involvement in any audit period transactions other than those allowed.

3. Findings

During interviews and document reviews, Liberty consultants obtained information about many transactions between SJG and affiliates. Liberty checked to see if those transactions violated the requirements of this section of the Standards. During Liberty's transaction testing, Liberty similarly checked to see if any of the transactions violated those same requirements. During transaction testing, Liberty found that most of the transactions it reviewed fit into corporate support services allowed by Sections 14:4-5.5(i) and (j).

SJG did, however, make available to SJE some services that it should have made available to other market participants. Millennium has done so twice while acting as a contractor for SJG: once in January 2001 and once in October-November 2003. The latter occasion fell within the audit period. Millennium provided these services under an October 26, 2001 contract with SJE. This contract's purpose was for Millennium to develop and maintain gas sales for SJE by acting "as a marketer for SJE services." The agreement specifically prohibited Millennium from offering to any other party services that competed directly or indirectly with those of SJE. Millennium personnel left SJE's residential brochures at SJG customer premises while Millennium employees read SJG meters. SJE paid Millennium on a commission basis. Millennium had to produce a customer-signed residential transportation agreement to earn a commission of \$25.00. The contract entitled Millennium to a minimum annual payment of \$20,000. The two-page flyer contains in small print at the end the disclaimer language.

Conduct that would be prohibited if performed by SJG should not become permitted simply because SJG chooses to perform a utility function through a contractor, whether affiliated or not.

The reference in the training materials (discussed above in Chapter IV of this report) allowing SJG employees to recommend affiliates for the provision of retail services not yet declared by the BPU to be “competitive” further shows the problem in SJG identification of prohibited transactions. SJG did not make the availability these services known to other market participants.

There has been no competitive bidding of the Millennium contract, but that issue is addressed in Chapter VIII of this report, which discusses implementation of recommendations from the preceding EDECA audit.

Liberty asked that SJG list each instance in which the utility provided customer information to an affiliate during the audit period. The response listed a number of billing information requests from SJE, in addition to the routine billing information that SJG provides to SJE and to all other third-party suppliers. An example of the kinds of reports requested for all marketers is the March 1, 2004 request by the SJG transportation department for the ability to produce a text file allowing each marketer to get a list of its customers according to SJG records, in order to verify the information. The audit-period reports for affiliate include:

- View-only access in February 2003 for SJE of SJE customer and commodity billing information
- An October 2003 download of rates charged to SJE customers to verify their accuracy
- A March 2004 special report for SJE containing a list of SJE customer falling into two rate groups.

The response also listed two instances of services or information provided to the appliance service business, for which SJG provided work-order management, billing, and inventory services:

- December 2002 extraction of a list of new utility customers to allow an offering of free warrantee service agreements to them
- February 2003 request for a list of work orders that would allow an identification of missing appliance parts by the appliance service business
- October 2003 request for a list of all appliance service customers not already scheduled for a preventive maintenance check, in order send a reminder to call in to schedule them
- March 2004 extraction of a list of customers who had contracted for preventative maintenance checks that were still pending, in order to allow a post card to be sent to them
- June 2004 request for programming work needed to support the transfer of the appliance service business to SJESP, covering payroll and pension, work-order management, service-order management, general ledger, and customer information systems.

SJG also provided SJI Internal Auditing with information that the auditors used to audit SJG:

- January 2003 provision of the utility billing register for an outside audit of financial statements
- May 2004 provision of customer identifications and meter numbers for testing bill processing.

The response also noted the existence of a marketing service agreement with a single vendor who provides marketing databases for SJG, SJE, and SJESP. The vendor provides prospect information for each of the three SJI entities. SJG reported that the databases are password-protected in order to isolate the access of each to its own information. Efforts were not taken to make the availability of such services known to other market participants; there was no posting of information related to the services.

All requests that SJE makes for customer information come through the SJG transportation department, which manages the customer relationship with all third party marketers, whether affiliated or not. SJI reports that there have been requests by third-party marketers, similar to those made by SJE for customer information. No such third party marketer requests, however, came to SJG during the audit period. The work orders for SJE requests do reflect routing through the SJG transportation department and they reflect review and approval by the SJG personnel responsible for managing utility customer information.

Liberty also sought to identify whether SJG made available to affiliates any services that it did not make available to other market participants. SJG entered effective September 1, 2002 an agreement to provide billing services for residential customers of SJE. The agreement covers billing and collection and enrollment processing services. The agreement allows SJG to charge \$0.075 per residential bill to cover billing, mailing, payment processing, electronic transfer of funds to SJE, and an accounts receivable report to SJE. The fee also covers SJG's one-time costs for programming. The agreement provided no charge for enrollment processing, except where SJE should fail to provide a customer account number, in which case an hourly rate of \$43.83 applied. The parties entered a new, similar agreement effective September 2004. It added commercial customers, and continued the per bill and the per hour rates of the prior agreement. It also provided for the purchase of SJE's receivables by SJG, at a rate that effectively discounted receivables by SJG's historical uncollectible rate.

SJG provided billing and services and receivables purchasing to five other, non-affiliated suppliers during the period. It charged the same \$.075 rate for billing and it calculated the receivables purchase rate in the same manner for all. Each, including SJE, signed the same standard contract for these services. SJG last notified marketers of the availability of these services in April 2000. As part of its renewal of these agreements in August 2004, SJG advised marketers with existing agreements that SJG had begun offering the option of purchasing the marketers receivables for commercial accounts. Previously, SJG only offered this service for residential accounts. SJG reports that no marketer has elected to take this service for commercial accounts.

The Compliance Plan restates this provision of the Standards and it refers to publication of energy transactions. It also includes a customer care operating procedure that prohibits providing leads or soliciting business for its retails competitive business services. The plan contains no information specifying the nature or location of any required posting of the availability of other services to other market participants. The rates and regulatory affairs department issued an October 2004 memorandum advising SJG gas supply management of the posting requirements of this provision.

The SJI director, market planning and forecasting serves SJG, SJE, and SJESP. He has the ability to secure access to the SJG marketing database when necessary to perform SJG marketing activities. The vice president of information services controls access to the SJG marketing database. He has responsibility for ensuring that his use of the information is limited to SJG. This access includes the SJG marketing database, which, although supported by a common vendor, is required to be kept separate from the corresponding databases of SJE and SJESP.

SJG makes no posting of the sales of services that it makes to the RCBSs of SJI and it does not publicly post any statement of the availability of such services to third parties who compete with those RCBSs.

The Compliance Plan merely restates this provision of the Standards. It contains no information specifying the nature or location of any required posting of the availability of services to other market participants.

4. Conclusions

a. SJG made services available to RCBSs without complying with the open availability requirements of this provision.

The marketing services provided by Millennium for SJE represent a particularly valuable service to SJE. Millennium offers economic and name recognition advantages that no other source of this service can match, given that:

- Millennium is the only entity reading meters for gas and electricity customers where Conectiv and SJG have common territory
- Many customers will know the Millennium meter readers as SJG representatives; therefore, their actions have at least the implicit imprimatur of SJG.

Not only did SJG fail to inform competitors of the availability of this service; SJE actually took firm steps to prevent Millennium from providing the service to others. The contract that authorized these services made Millennium a marketing partner of SJE, in the sense that it paid commission-type success fees, and specifically prohibited Millennium from providing the services to anyone who competed with SJE. Moreover, the prohibition extended beyond the specific advertisement-hanging services; it banned any Millennium from serving others in any way that would be competitive with SJE.

b. SJG does not post the availability of billing and receivables services for marketers, but has, with one possible exception, succeeded in keeping marketers aware of these services.

Billing and receivables purchasing services comprise a core service to marketers; it is likely that experienced marketers know that the local LDC will provide such services on non-discriminatory terms. A significant number of marketers use SJG to provide these services. It appears clear that they know that SJG will provide them, despite the lack of posting. The fact that SJG has not made a general announcement of these services since 2000 is, however, a matter that should be addressed. SJG has made at least one change since 2000; adding commercial accounts to the

offering, which highlights the need for occasional updating of offerings to the general marketplace.

c. SJG did not post the availability of a variety of other, less standard services that it provided to RCBSs

SJG did provide several other services, mostly associated with customer information systems, that should have been posted for review by other market participants. This conclusion addresses the same issue and the same weakness that addressed in the immediately preceding section, and raises no concerns or needs for remedial action other than those addressed in that section.

d. SJG provided sufficient control over assuring that its customer information provided to affiliates was within the limits imposed by the Standards.

Other sections of this report address these controls in detail; however, for purposes of this section, Liberty notes that the manner in which SJG routes, processes, and fulfills requests for customer information comprise a notable strength in their ability to assure that RCBSs do not gain access to customer information that is protected by the Standards.

e. The Compliance Plan's simple restatement of the obligations of this provision of the standards does not provide sufficient guidance to employees.

The Millennium marketing work for SJE provides an example of a very significant misinterpretation of what the Standards ban. The simple restatement of the words of this provision failed to be effective. This example also demonstrates violations of the same requirement by both SJG and an RCBS (*SJE*). It therefore highlights the kinds of violations that can result from a failure of SJI to require its RCBSs to provide their own guidance and training in Standards implementation. See the discussion of conclusions and recommendations under Chapter IV of this report for details. SJG also made a number of other services available to an RCBS without public posting.

5. Recommendations

9. Incorporate into the Compliance Plan specific methods, location, and timing for the posting of the availability of services to other market participants.

SJG does not make the availability of such services known to other market participants. Doing so would enable them to elect to take similar services, as the Standards require. It would also allow them and the BPU timely access to information about activities, like the use of Millennium to serve SJE while it was operating as a contractor for SJG, that raise concerns beyond the question of access by third parties.

10. Given the historical lack of sound definition of and control over prohibited activities, incorporate into the Compliance Plan and into guidance and training (including that for RCBSs) a comprehensive discussion of what transaction types the Standards prohibit.

Making the change recommended by the preceding recommendation will comprise a significant change in direction for SJI/SJG in their interpretation and actions regarding Standards

compliance. Given this change, it is important to make sure that the compliance plan and the training and guidance for both SJG and RCBSs make clear that what SJI has permitted in the past may not occur in the future.

11. Provide all marketers with updates of billing and receivables services provided, including rates, and make further updates when changes occur, but not less frequently than every other year.

The web-site will suffice as an efficient means for providing these updates.

C. Access to Information and Services

1. Statement of Applicable Requirements

Section 14:4-5.3(c) of the Standards provides that:

An electric and/or gas public utility shall provide access to utility information, services, and unused capacity or supply on a non-discriminatory basis to all market participants, including affiliated and non-affiliated companies...

Listed exceptions are for:

- Joint purchases (Section 14:4-5.5)
- Corporate support (Section 14:4-5.5)
- Competitive products or services offered by an RCBS within the utility, as allowed by Sections 14:4-5.6.

2. Summary of Audit Activities

This section's anti-discrimination provisions generally are the same as those set forth in Section 14:4-5.3(a). What makes it particularly different is the imposition of the following requirement regarding public posting of offerings made by the utility:

1. If an electric and/or gas public utility provides supply, capacity, services, or information to a related competitive business segment of its public utility holding company, it shall make the offering available, via a public posting, on a non-discriminatory basis to non-affiliated market participants, which include competitors serving the same market as the related competitive business segment of the electric and/or gas public utility's holding company.

This standard also, unlike the one set forth in preceding subsection (a), introduces the concept of utility provision of "information" as a possible source of preference or discrimination. This audit's examination of utility performance in making information available is addressed in other sections of this report, *e.g.*, 5.3(m), 5.4(a), 5.4(b), 5.4(d), 5.4(e), 5.5(e), 5.5(j), 5.5(s), which address the sharing of information among affiliates.

Given the relationship of this subsection with the preceding one, Liberty carried out its audit work on the two provisions together. The work relevant here, which the previous section of this report discusses in detail, used criterion:

- Whether the utility made a public posting of all offerings of services (if any) that it made available to a holding company RCBS.

3. Findings

Liberty's findings for this provision are subsumed in the conclusions set forth for Section 14:4-5.3(b), a discussion of which Liberty provides in the report section immediately preceding this one.

4. Conclusions

Liberty's conclusions for this provision are subsumed in the conclusions set forth for Section 14:4-5.3(b), a discussion of which Liberty provides in the report section immediately preceding this one.

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision, apart from the relevant ones set forth in the recommendations for Section 14:4-5.3(b), a discussion of which Liberty provides in the report section immediately preceding this one.

D. Short-Term Sales of Surplus Energy or Capacity

1. Statement of Applicable Requirements

Section 14:4-5.3(d) of the Standards provides that:

An electric and/or gas public utility selling or making an offer to sell surplus energy, kWh and/or Dth, respectively, and/or capacity, kW or therms, respectively, on a short term basis to its PUHC or a related competitive business segment of its public utility holding company, shall make the offering available on a non-discriminatory basis to non-affiliated electric or gas marketers, via a public posting.

2. Summary of Audit Activities

These provisions require that if the utility offers to sell surplus energy or capacity to its PUHC or an RCBS of its PUHC on a short-term basis (transactions of 31 days or less), the utility must make the offering available to non-affiliated companies via a public posting. Because the requirements for short- and long-term sales are similar, Liberty examined both types through the same audit activities.

Liberty first sought information from SJG about its selling of excess energy and capacity on both a short-term and long-term basis. Liberty also reviewed the utility compliance plan, specifically any portions dealing with surplus energy and capacity.

Liberty applied the following criteria in its evaluation of performance under this standard:

- Whether the utility's compliance plan adequately addresses the requirements applicable to offerings made to an RCBS

- Whether the utility made a public posting of all offerings (if any) made available to a holding company RCBS.

3. Findings

The Compliance Plan restates the Standards, and notes the location where any public postings would be made. The rates and regulatory affairs department issued an October 2004 memorandum advising SJG gas supply management of the posting requirements of this provision.

SJG provided a general listing of available short-term offerings on an electronic bulleting board. SJG began to use its web site for these listing at the beginning of 2004. These listings generally provide the duration available, the delivery point, and the character of service; *e.g.*, firm. The listings did not include price. The listings generally did not provide volumes, or listed them as zero. SJG has not posted any of the particulars of actual transactions that it has made to affiliates. Third parties, therefore, cannot discern from the available information what quantities and prices SJG offered or eventually provided to affiliates.

SJG stated that third parties interested in SJG capacity and gas available fro remarketing do not use this list in any case. When these market participants have needs, they know that they can simply call SJG to determine what offerings the utility may have available. Liberty conducted detailed examinations of capacity and supply transactions between SJG and its affiliates. That review specifically addressed the issue of price favoritism to affiliates. Liberty's work found no indication that affiliates paid prices lower than those paid by third parties for similar transactions. Chapter VIII of Liberty's report on *Gas Supply* describes this test work in detail.

4. Conclusions

- SJG has routinely made known to third parties the general types of capacity and gas-supply offerings that it has available, but third parties had to contact SJG to learn specifics and negotiate price.**

These postings did not provide any transaction-specific information, or give third parties an opportunity to evaluate specifically whether they had interest in the specific transactions, including prices, quantities, and durations offered to affiliates.

- SJG's "postings" did not make publicly available to third parties the same terms and conditions that it offered to affiliates.**

Third parties could not use the postings to evaluate a specific transaction, nor could they determine whether they ultimately achieved, through negotiations, similar terms and conditions as those provided to affiliates.

- Liberty's review found no pattern of price discrimination in favor of affiliates with respect to transactions covered by this provision.**

The nature of SJG's postings failed to allow third parties to make their own determination of price comparability. Liberty did, however, perform testing of the pricing of RCBS versus third-

party transactions having common characteristics. Liberty found the prices for similar transactions to be comparable. Chapter VIII. of Liberty's report on *Gas Supply* addresses that testing in detail.

5. Recommendations

12. Provide greater detail in transaction posting.

What SJG has posted does not meet what Liberty construes to be an *offering* in any usual sense of the term. What SJG has posted amounts to an invitation to negotiate an agreement. The two are not the same. The difference has special significance here, where it is important to assure that there has been arms'-length dealing with affiliates. Liberty emphasizes that the available evidence supports the conclusion that there has been, with respect to the pricing of similar transactions. Liberty could find no way to test reliably other aspects of offerings, such as whether SJG offered similar durations and delivery durations even handedly, but found no evidence that SJG did not.

The difficulty literal compliance with this provision is largely one of timing. SJG provides advance notice of availability, which is a strength of SJG's approach. It allows third parties to know well ahead of time that there is a potential for securing portfolio elements with SJG. The weakness in SJG's approach is that its postings sometimes appear to remain unchanged for extended periods and often imply that there is no volume available. This last implication arises from the use of zero as the designated quantity for certain postings. There is certainly merit to SJG's position that such vagueness or uncertainty can be readily addressed through contact with SJG. High-cost transactions such as these, will certainly take such contact to complete in virtually all cases in any event.

There is also the question of competitive information. Allowing competitors to know what an affiliate has paid may disadvantage that affiliate, because there is no similar obligation for SJG to tell its affiliate what it has charged those competitors. Moreover, telling competitors what the affiliate, or anyone else for that matter, has paid, may damage the SJG and its customers, because it will enable an offeror to use that information as leverage in negotiating price with SJG. There is a need considering issues like these in interpreting what this provision requires.

Nevertheless, there remains the question of what this provision requires, which is a posting of *offerings*. What SJG posts do not meet the definition of that term. Audits such as this one can, as this one has, ultimately get to the question of price favoritism; they probably cannot effectively reach an answer on other parameters, which may be just as important. SJG therefore, should:

- Provide significantly more detail in its postings, particularly as to available quantities
- Update them at least weekly and post the update time, even if only to confirm that no information has changed
- Provide summaries of all transactions monthly, including price and other key parameters, to the BPU monthly, in order to allow the BPU to promote public confidence in the arms'-length nature of SJG dealings with affiliates.

E. Long-Term Sales of Surplus Energy or Capacity

1. Statement of Applicable Requirements

Section 14:4-5.3(e) of the Standards provides that:

An electric and/or gas public utility selling or making an offer to sell surplus energy, kWh, and/or Dth, respectively, and/or capacity, kW or therms, respectively, on a long term basis to its PUHC or a related competitive business segment of its public utility holding company, shall make the offering available on a non-discriminatory basis to non-affiliated electric or gas marketers, via a public posting.

2. Summary of Audit Activities

These provisions require that if the utility offers to sell surplus energy or capacity to its PUHC or an RCBS of its PUHC on a long-term basis (transactions of greater than 31 days), the utility must make the offering available to non-affiliated companies via a public posting.

Liberty's audit activities were the same as those set forth for Section 14:4-5.3(d), which the immediately preceding section of this report addresses.

3. Findings

Liberty's audit activities were the same as those set forth for Section 14:4-5.3(d), which the immediately preceding section of this report addresses.

4. Conclusions

Liberty's conclusions are the same as those set forth for Sections 14:4-5.3(d), which the immediately preceding section of this report addresses.

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision, apart from those set forth for Sections 14:4-5.3(d), which the immediately preceding section of this report addresses.

F. Discounts or Waivers of Fees or Charges

1. Statement of Applicable Requirements

Section 14:4-5.3(f) of the Standards provides that:

Except when made generally available by an electric and/or gas public utility through an open, competitive bidding process, an electric and/or gas public utility shall not offer a discount or waive all or part of any other charge or fee to a related competitive business segment of its public utility holding company, PUHC, or offer a discount or waiver for a transaction in which a related competitive business segment of its public utility holding company is involved

unless the electric an/or gas public utility shall make such discount or waiver available on a non-discriminatory basis to other market participants.

1. An electric and/or gas public utility shall not give its PUHC or a related competitive business segment of its public utility holding company involved in energy supply or marketing a preference with respect to tariff provisions that provide for discretionary waivers of fees, penalties, etc., unless offered to all others on a non-discriminatory basis.

2. Summary of Audit Activities

This section prohibits a utility from offering a discount or waiver of any charge to or for the benefit of an RCBS of its holding company, unless it makes the same concessions to non-affiliates.

Liberty first sought to identify any instances during the audit period when SJG may have offered a discount or waiver to an RCBS. In the event that there were any, Liberty then intended to determine whether the utility made the same concessions available to non-affiliates through an open process.

As a first step, Liberty formally asked whether the utility provided any discounts, waivers, or the like to its holding company or to an RCBS of its holding company during the audit period.

During interviews and document reviews addressing transactions among affiliates, Liberty also obtained substantial information about transactions between the utility and its affiliates. Liberty examined that information for evidence of any discount, waiver, rebate, etc. to an affiliate. In the event that any discounts or waivers were found, Liberty then intended to examine whether they were similarly offered to non-affiliates.

The criteria that Liberty applied in examining performance under this standard were:

- Whether the utility compliance plan adequately addresses its obligations under this standard
- Whether, in the event that there were any covered transactions, similar offerings were made to non-affiliates.

3. Findings

SJG stated that did not provide any discounts or fee or charge waivers to an RCBS of its holding company. The Compliance Plan restates this section, and notes that tariff issues fall within the responsibility of the rates and regulatory affairs department. This department issued an October 2004 memorandum asking that all transactions involving a discount be reported to it for prior approval, and noting that it would make interpretations of tariff provisions.

4. Conclusions

- a. During the audit period, SJG did not engage in activity concerning which the requirements of Standards Section 14:4-5.3 (f) would apply.**

- b. The Compliance Plan specifies who has responsibility for enforcing this provision and how it will be enforced.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

G. Documentation of Discount Bases

1. Statement of Applicable Requirements

Section 14:4-5.3(g) of the Standards provides that:

An electric and/or gas public utility shall document the cost differential underlying the discount to its PUHC or a related competitive business segment of its public utility holding company in the Affiliate Discount Report described in (o) through (q) below.

2. Summary of Audit Activities

This section requires the utility to document the basis for any discount offered to the holding company or an RCBS of its holding company. Liberty first sought to determine those instances during the audit period when SJG may have offered a discount or waiver to its holding company or to an RCBS of a holding company. In the event that there were any, Liberty then intended to determine whether the company properly documented the basis for any discount offered to the RCBS.

3. Findings

As discussed with respect to Section 14:4-5.3(f), SJG did not offer discounts or waivers to RCBSs of SJI. Therefore, documentation of such discounts was not required. The Compliance Plan restates this section, and notes that tariff issues fall within the responsibility of the rates and regulatory affairs department. This department issued an October 2004 memorandum asking that all transactions involving a discount be reported to it for prior approval, and noting that it would make interpretations of tariff provisions.

4. Conclusions

- a. During the audit period, SJG did not engage in activity concerning which the requirements of Standards Section 14:4-5.3 (g) would apply.**
- b. The Compliance Plan specifies who has responsibility for enforcing this provision and how it will be enforced.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

H. Non-Discriminatory Tariff Enforcement

1. Statement of Applicable Requirements

Section 14:4-5.3(h) of the Standards provides that:

An electric and/or gas public utility shall apply tariff provision(s) on a non-discriminatory basis to its PUHC or related competitive business segments of its public utility holding company and to other market participants and their respective customers if the tariff provision allows for discretion in its application.

2. Summary of Audit Activities

These provisions prohibit a public utility from discriminating in favor of its holding company or an RCBS of its holding company in the following two ways:

- Failing to enforce tariff requirements fully
- Giving an affiliate relatively greater benefit where a tariff may allow the exercise of latitude.

As a threshold matter, Liberty sought to determine the full extent of tariff services provided by SJG to affiliates during the audit period. Liberty would use this information to determine whether the utility had engaged in any activity covered by the requirements imposed by this section of the Standards. Liberty would then identify and carry out any test activities considered appropriate in testing compliance with those requirements.

Liberty applied the following criteria in evaluating utility performance in areas related to this provision of the standards:

- Whether the utility compliance plan adequately addresses its obligations under this standard
- Whether, in the event that there were any covered transactions, similar offerings were made to non-affiliates.

3. Findings

The Compliance Plan restates this section, and notes that tariff issues fall within the responsibility of the rates and regulatory affairs department. This department issued an October 2004 memorandum asking that all transactions involving a discount be reported to it for prior approval, and noting that it would make interpretations of tariff provisions.

4. Conclusions

- a. During the audit period, SJG did not engage in activity concerning which the requirements of Standards Section 14:4-5.3 (h) would apply.**
- b. The Compliance Plan specifies who has responsibility for enforcing this provision and how it will be enforced.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

I. Strict Tariff Enforcement

1. Statement of Applicable Requirements

Section 14:4-5.3(i) of the Standards provides that:

An electric and/or gas public utility shall strictly enforce a tariff provision if the tariff provision does not allow discretion in its application.

2. Summary of Audit Activities

This provision corresponds to the previous standard set forth in Section 14:4-5.3(h). The difference is that the previous standard applies to enforcement of tariff provisions that allow the utility to exercise discretion, while this one applies to the enforcement of tariff provisions whose implementation does not allow utility discretion. Given the similarity in requirements, Liberty's audit activities and evaluation criteria were the same as those set forth for Section 14:4-5.3(h).

3. Findings

The Compliance Plan restates this section, and notes that tariff issues fall within the responsibility of the rates and regulatory affairs department. This department issued an October 2004 memorandum asking that all transactions involving a discount be reported to it for prior approval, and noting that it would make interpretations of tariff provisions.

4. Conclusions

- a. **During the audit period, SJG did not engage in any activity concerning which the requirements of Standards Section 14:4-5.3 (i) would apply.**
- b. **The Compliance Plan specifies who has responsibility for enforcing this provision and how it will be enforced.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

J. Processing Affiliate Service Requests

1. Statement of Applicable Requirements

Section 14:4-5.3(j) of the Standards provides that:

An electric and/or gas public utility shall process all requests for similar services provided by the electric and/or gas public utility on a non-discriminatory basis for its PUHC or a related competitive business segment of its public utility holding company and for all other market participants and their respective customers.

2. Summary of Audit Activities

These provisions prohibit a public utility from discriminating in favor of its holding company by giving affiliates faster, cheaper, or technically superior service when they request new service, changes in existing service, or eliminations of current service. As a threshold matter, Liberty sought to identify all service requests from affiliates during the audit period. Liberty would use this information to determine whether the utility engaged in any activity covered by the requirements imposed by this section of the Standards. Liberty would then identify and carry out any test activities considered appropriate in determining compliance with those requirements.

The criteria that Liberty applied in examining utility performance under this standard were:

- Whether the utility compliance plan adequately addresses its obligations under this section of the standards
- Whether there is any evidence that the utility offered its holding company or any holding company RCBS a preference in responding to service requests.

3. Findings

SJG stated that it did not receive any requests for new or changed services from any RCBS during the audit period. Therefore, no testing was required. The Compliance Plan recites this provision of the standards, and notes that management employees have been generally advised about it.

4. Conclusions

- a. During the audit period, SJG did not engage in activity concerning which the requirements of Standards Section 14:4-5.3 (j) would apply.**
- b. The Compliance Plan's treatment of this provision of the Standards, unlike that for other provisions related to the provision of utility service to affiliates, fails to make the rates and regulatory affairs department responsible for enforcement.**

5. Recommendations

- 13. Change the Compliance Plan to require the involvement of The Rates and Regulatory Affairs Department in processing affiliate service requests in a manner similar to its role with respect to other provisions related to tariffed services to affiliates.**

While material to assuring the completeness of compliance controls, this recommendation should not have substantial operational significance, given the lack of tariffed services from SJG to affiliates.

K. Tying Arrangements

1. Statement of Applicable Requirements

Section 14:4-5.3(k) of the Standards provides that:

An electric and/or gas public utility shall not condition or otherwise tie the provision of any products and/or services provided by the electric and/or gas public utility, nor the availability of discounts of rates or other charges or fees, rebates, or waivers of terms and conditions of any products and/or services provided by the electric and/or gas public utility to the taking of any products and/or services from its PUHC or a related competitive business segment of its public utility holding company.

2. Summary of Audit Activities

This section prohibits the utility from tying the provision of goods or services, discounts, rebates or waivers to the taking of products or services from its PUHC RCBS. The criteria that Liberty employed in examining utility performance with respect to this standard were:

- Regular customer communications should not directly or indirectly indicate that the availability of or the conditions associated with taking any utility service have any connection to the taking of service from an affiliate.
- The utility compliance plan should offer employees explicit instructions with respect to avoiding direct or implied statements that tying is necessary for securing utility services or advantageous with respect to the terms and conditions applicable to utility service.

Liberty reviewed utility customer communications, including information provided to customers inquiring about Energy Choice, utility bill inserts, advertising, and the Company website for any representation or implication with respect to tying the taking of goods or services from a PUHC RCBS to the provision of utility services. Liberty also reviewed the utility's compliance plan to ensure that the action of tying utility products or services to the taking of products or services from an affiliate is specifically prohibited.

3. Findings

As noted above regarding Section 14:4-5.3(a) of the Standards, SJG does not represent in its customer communications or on its website any implication of preferential treatment for any PUHC RCBS or the customers of any PUHC RCBS. These conclusions also apply to any conditions or tying of the provision of utility services or discounts to the taking of any products from a PUHC RCBS. The Compliance Plan recites this provision of the standards, and notes that management employees have been generally advised about it.

4. Conclusions

- a. SJG does not specify or imply in its customer communication the tying of the provision of utility goods and services to the taking of products and services from its PUHC RCBS.**

- b. Liberty found no evidence of the tying of the provision of utility products and services to the taking of goods and services from its PUHC RCBS.
- c. The SJI web site does not specify or imply the tying of the provision of utility products and services to the taking of goods and services from its PUHC RCBS.
- d. SJG's Compliance Plan treats this provision adequately.

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

L. Customer Assignments

1. Statement of Applicable Requirements

Section 14:4-5.3(l) of the Standards provides that:

An electric and/or gas public utility shall not assign customers to which it currently provides products and/or services to any related competitive business segments of its public utility holding company, whether by default, direct assignment, option or by any other means, unless that means is equally available to all competitors on a non-discriminatory basis.

2. Summary of Audit Activities

This provision prohibits a public utility from discriminating in favor of RCBSs of its holding company when assigning customers. The criteria that Liberty employed in examining utility compliance with this requirement were:

- The utility compliance plan should adequately inform employees about their obligations under this section
- In the event that any customer assignments took place during the audit period, there should be clear and convincing evidence that there was no discrimination against competitors in making such assignments.

Liberty reviewed the utility compliance plan. Then, Liberty sought to identify all cases where the utility may have assigned customers to any party, affiliated or not, during the audit period. Liberty would use this information to determine whether the utility engaged in any activity covered by the requirements imposed by this section of the Standards. Liberty would then identify and carry out any test activities considered appropriate in examining testing compliance with those requirements.

3. Findings

SJG did not make any assignments of customers to any party during the audit period. Therefore, no testing was required. The Compliance Plan recites this provision of the standards, and notes that management employees have been generally advised about it.

4. Conclusions

- a. During the audit period, SJG engaged in no activity concerning which the requirements of Standards Section 14:4-5.3 (l) would apply.
- b. The Compliance Plan recites this section, but does not provide sufficient detail about its enforcement.

5. Recommendations

14. Change the Compliance Plan to require the involvement of the rates and regulatory affairs department in customer assignments in a manner similar to its role with respect to Standards' provisions related to tariffed services to affiliates.

While material to assuring the completeness of compliance controls, this recommendation should not have substantial operational significance, given the lack of customer assignments from SJG to affiliates.

M. Customer Enrollment, Marketing, and Business Development

1. Statement of Applicable Requirements

Section 14:4-5.3(m) of the Standards provides that:

Except as otherwise provided by these standards, an electric and/or gas public utility shall not provide any assistance, aid or services to its PUHC or related competitive business segment of the PUHC if related to customer enrollment, marketing, or business development unless offered to all competitors on a non-discriminatory basis.

2. Summary of Audit Activities

The section lists the following examples of assistance to the PUHC or to an RCBS of the PUHC:

- Providing leads
- Soliciting business
- Acquiring information on behalf of the PUHC or an RCBS of the PUHC
- Sharing market analysis reports or other types of proprietary reports
- Sharing customer usage or end-use equipment information
- Requesting authorization from its customer to pass on customer information exclusively
- Representing or implying that the utility speaks on behalf of the RCBS or that the customer will receive preferential treatment as a consequence of conducting business with the RCBS
- Representing or implying that the RCBS speaks on behalf of the public utility.

These provisions prohibit a public utility from assisting its holding company or the RCBSs of its holding company in customer enrollment, marketing, and business development. Liberty

reviewed the utility's compliance plan for adherence to these provisions. In addition, Liberty reviewed business plans, training for customer-service representatives, information recipients, marketing materials, bill inserts, customer and competitor complaints, and information acquisition and dissemination. This review was to ensure that the utility was not participating in any prohibited activity involving its holding company or holding company RCBSs.

The criteria that Liberty employed in examining compliance with this standard were:

- The utility compliance plan should adequately address the requirements of this provision of the Standards.
- There should exist controls adequate for assuring compliance with the requirements of this provision of the Standards.
- The utility should scrupulously avoid conduct that provides assistance, support, or services that aid RCBSs, unless offered to other market participants.

3. Findings

Liberty reviewed the SJG Compliance Plan. The plan recites this provision, and notes that SJG implemented a communications plan (addressed earlier in this Chapter) to assure awareness of applicable rules.

Liberty reviewed SJI, SJG, and affiliate strategic and business plans for adherence to these provisions, and found that the plans complied with this provision of the Standards. Liberty also reviewed the information provided during the planning process to ensure that competitively sensitive information such as market analysis, customer usage information, and end use information are not inappropriately shared. Liberty found that during the planning process each of the affiliated companies prepares its own business plan.

Liberty found that the structure of the marketing function at SJI provided significant and inherently difficult-to-control opportunity for utility marketing information to become accessible to affiliates. Section VII.J. provides Liberty's findings, conclusions, and recommendations intended to provide a more effective structure for complying with the Standards.

SJG does not provide customer information unless requested by the customer. Liberty also found that during the period of the audit, SJG has not had a competitor or consumer complaint concerning the improper release of information.

Both SJG and SJE have used the Cura Group from April 2001 through December 2004 to assist in a variety of sales re-engineering efforts. The activities that this contractor assisted in have included sales force structuring, work process and activity design and sequencing, job description development, base and incentive compensation structuring, and recruitment. Liberty's review of the materials presented to describe these efforts showed that there was at least some joint consideration of SJE and SJG issues in the same engagement, a sharing of engagement materials between SJE and SJG, and explicit recognition of the transferability of work for one entity to the other. The following persons received Cura proposals and work products:

- Chairman of the Board

- CEO
- SJG executive vice president and chief administrative officer (also an SJI vice president)
- SJG Senior vice president, corporate communications and administrative services
- SJI director, market planning and forecasting
- SJG director, gas sales
- SJG director, human resources

The SJI Marketing Planning and Forecasting Department, which performs services for SJG, SJI, and SJESP, proposed a plan for SJG to support fall 2004 residential heat conversion efforts. The plan recommended the offering of free heating units and low cost financing of the installation of these units. The SJI director, market planning and forecasting authored the plan. The SJG/SJI vice president approved it. The head of SJI market planning and forecasting, who is also the officer responsible for overseeing the operations of SJE and SJESP, also approved it.

The plan recognized that “The key to a successful marketing campaign is the quality of the list being used.” Its author based it upon screening current customer by excluding:

- Customers already using gas for heating
- Non-homeowners
- Customers with bad credit

The screens applied reduced the total pool of 19,000 current residential non-heat customers to a target audience (incorporated into a database) of about 6,900, broken down by each of the seven counties in which SJG provides utility service. The plan’ total estimated costs for expected conversions amounted to \$740,000, or about \$1,000 per customer, assuming:

- An offering only to the target audience database through direct mail, door-to-door contacts, and use of a telemarketer
- A free natural gas furnace, whose costs SJG would absorb
- Customer retention of any \$300 rebate applicable through the NJ Clean Energy Program
- Low cost financing of installation costs, up to a maximum of \$8,000
- Installations to be completed by the end of 2004.
- A total of 690 conversions

Expected revenues would produce a break-even point of somewhat less than six years at the number of projected conversions. Early response produced conversions at levels much lower than expected. Approved conversions amounted only to 82 by early November 2004. The number grew significantly, but not enough to meet expectations. SJG reported 237 completed conversions by the end of 2004. It expected less than 100 more conversions through the program’s expiration. SJG extended that end date from December 31, 2004 to March 1, 2005.

SJI marketing had the responsibility to evaluate program effectiveness through examination of completed “Additional Gas Load Request” forms sent to them by SJG sales personnel.

The plan noted that SJG expected SJESP expected to become a preferred contractor, and participate in the program. The initial list of approved contractors showed 14 members as of the end of July 2004. SJESP was one of them. SJG added 21 more contractors by the end of October

2004. The number reached 43 by mid January 2005. All but one of the committed conversions through early November 2004 had gone to nine of the original list members. One conversion went to a contractor added in mid-October. Another eight contractors had secured a conversion customer by December 2004.

SJG reported receiving 1,030 inquiries through January 14, 2005. These initial inquiries resulted in 634 leads given to contractors. SJESP, despite having been on the list almost since inception, received only 10 of them, which was less than the average of about 15. SJESP secured its first and only 2004 conversion very late in 2004. Fourteen contractors received more referrals than SJESP did; 10 of them receiving 25 or more referrals and 6 of them received in excess of 50.

The following table shows the costs that SJG booked in about \$ [REDACTED] in 2004 costs for the heating equipment and loan support elements of the program.

Table V-2. Conversion Program Variable Costs

Component	Account	Amount
0% loans	[REDACTED]	\$ [REDACTED]
2.9% loans	[REDACTED]	[REDACTED]
Heating equipment paid for by SJG	[REDACTED]	[REDACTED]
<i>TOTAL</i>		[REDACTED]

The following table shows the SJG conversion customers (including those who took advantage of the promotional program) who have ended up taking gas supply from SJE or appliance services from SJESP.

Table V-3. Affiliate Share of Conversions

	2003	2004
Conversions	1882	1245
SJE Customers	154	7
SJE Conversion Share (%)	8.2	0.5
SJE Total SJG Meter Share (%)	30	24
SJESP Customers	1882	960
SJESP Conversion Share (%)	100	77.1
SJESP Total SJG Meter Share (%)	24	24.5

The SJE share of the conversion market falls significantly below the total share of SJG customers for whom SJE provides supply. The gap increased in 2004 because SJE ceased taking on new customers and turned a number back to SJG in late 2004. SJE found itself unable to compete on price with SJG system-supply service. SJE's share of the residential market at the end of 2003 comprised 87,500 customers, or 33 percent. The preceding table shows its share of all customers, not just residential ones. SJE's goal was to [REDACTED] during 2004. SJE's commercial market share ran to 15 percent, with a goal to [REDACTED] by 2006.

The SJESP share of conversions far exceeded its embedded share SJG's market because SJG offered a free 12-month service contract during the time that the utility offered appliance services. SJG ceased that offer upon the transfer of the appliance service business to SJESP effective in September 2004. The effect of ceasing this offer was significant, as the drop-off in the SJESP conversion market share in 2004 demonstrates.

SJG's marketing materials describing the preferred contractor program to potential participants note its connection to gas conversion efforts of the utility, and emphasize that the selected group comprises only "elite" members of the HVAC contracting community in the region. Contractors must provide the following to become preferred contractors:

- Company and owner name
- Area served
- An annual participation fee of \$500
- A signed "Preferred Contractor Agreement" including minimum insurance requirements

SJESP filed an application, provided a certificate of insurance, and made payment of the \$500 at the time it sought inclusion in the program.

SJG provides periodic communications with preferred contractor list members, but did not provide Liberty with information showing that it extends broad, non-discriminatory invitations to membership on a recurring basis.

This program raised a number of issues appropriate for examination in this focused audit:

- Access to utility marketing information (specifically quantitative and qualitative data about current utility customers who could be profitably served by switching to gas heat)
- Non-discriminatory treatment of SJG affiliates in gaining access to the SJG preferred contractor list, which SJG has used to recommend contractors to install the units
- Non-discriminatory treatment of SJG affiliates in securing rotational opportunities to visit interested customers to discuss conversion
- Provision of customer-specific information or leads to an affiliate
- Source of funding for heat units and subsidized financing costs.

Liberty reviewed the printed marketing materials and telemarketer scripts for the Fall 2004 heater-conversion incentive program. All made clear that SJG was the sponsor of the program, and made no direct or indirect mention of the use of its affiliates to perform installations, maintain equipment after installation, or serve as a third-party supplier of natural gas. Materials sent to the target audience referred to the SJI, not the SJG website. SJG did not share the forms it used to administer the program with affiliates or with the SJI marketing planning and forecasting department, which serves both SJG and SJE. That group, however, will eventually have access to program statistical data, in order to judge the offer's effectiveness after completion.

SJG paid SJG customer care center personnel bonuses for successfully negotiating appliance-service contracts (the so-called *Service Sentry Plan*) when SJG customers called for gas-service reasons. SJG originally intended to end that bonus program when SJESP took over the appliance-service business. SJG expected to receive overflow calls for SJESP customers, as allowed by the BPU approval of the transfer of the appliance-service business from SJG to

SJESP. The companies decided to allow SJG representatives to continue receiving such bonuses when, during an overflow call, they persuade a person making a call about SJESP to sign up for the *Service Sentry Plan*.

SJESP performed installation work from June 2003 through August 2004. This work differs from the SJG appliance service and repair business that SJESP acquired in 2004. SJESP advertised this installation work in a number of manners during this period:

- April 2004: Verizon Yellow pages advertisements
- April and May 2004: 30-second cable television advertising spots
- July 2004: 5,000 direct-mail postcards
- June 2004: a Val Pak advertisement targeted to 70,000 customers

SJESP provided five ads used as part of these campaigns. All used the SJESP name and the common SJI logo. Two of the five included the standard disclaimer. SJESP used a list of existing ASB *Service Sentry* customers from the Third Wave database to generate the direct mail postcard addressee list. Note that the installations being promoted were by SJESP, not by the SJG appliance service business, which continued to operate separately until August 2004. The Val Pak mailing list came from a zip-code database, not from SJI or SJG databases.

4. Conclusions

a. SJG provided material customer enrollment, marketing, and business development assistance to SJE and SJESP in violation of the requirements of Section 14.4-5.3(m).

The marketing arrangement between Millennium, while acting in the performance of an SJG function, provides one significant example. Chapter V.B. of this report discusses that situation in more detail. The provision of 12-month SJESP service contracts as part of heater-conversion promotion efforts in 2003 and 2004 provide another. This offering did cease when SJESP took over the appliance-service business. Nevertheless, with an application pending for the approval of that transfer, offering agreements for such a long duration clearly had the intent of assisting SJESP, an RCBS of SJG's holding company. The goal of the offering was to for the longer term customer appreciation of services that SJI and SJG clearly expected to be provided by SJESP. The provision of an ASB customer list (while SJG still operated this business) for SJESP to use in promoting its equipment installation business provides a third example.

b. The planning processes of SJG and the RCBSs of its holding company are reasonably distinct and separate.

Liberty found no indication that the planning processes serve as a conduit for the sharing of information that this provision of the Standards addresses.

c. SJG's Compliance Plan otherwise adequately addresses this provision of Section 14:4-5.3(m) of the Standards.

d. Apart from the SJESP 12-month service contract offering, SJG conducted the heater conversion program appropriately.

The only EDECA-related complaints that SJI/SJG received during the audit period from third-parties with whom they compete concerned the heater conversion program. Liberty conducted a detailed review of this program. Liberty found that SJG led the planning and design of the program. The expected pay-back period marginally exceeded SJG's normal standard, but not by so much as to call its fundamental reasonableness into question. The assumptions of the program proved to be optimistic, but its low fixed costs made it a reasonably low-risk utility venture.

The program bore a reasonably close relation to SJG-specific objectives. It made economic sense for SJG regardless of who performed the installations, serviced the equipment, or sold the increased amounts of gas to the customers. These three activities comprise those in which SJG affiliates, either SJE or SJESP, have a business interest.

SJG conducted the contractor referrals in an arms'-length manner. It publicized the availability of the program to the contractor community, it imposed reasonable conditions on qualification for referrals, it applied those conditions equally to SJESP, and it did not favor SJESP in number of referrals provided. The data that Liberty examined show that SJE did not gain unfair advantage under the program's operation either. SJE's business retrenchment in 2004 distorts the data somewhat, but it nevertheless remains clear that it did not gain market-share advantage through the operation of the conversion program. SJE fared significantly more poorly among converting customers than fared among the general residential population.

e. The unusual origin of SJG's role with respect to SJESP calls makes bonuses for SJP personnel appropriate, but difficult to administer.

The BPU has considered the question of using SJG personnel to take overflow SJESP calls. It is reasonable for SJG personnel who take those calls to do for SJESP all that SJESP's own personnel would do. The selling of added SJESP services to existing SJESP customers on calls placed by those SJESP customers should be allowed. Compensating SJG personnel in a manner similar to how SJESP compensates its own personnel is therefore appropriate. However, two cautions are important:

- It must be clear that similar selling is not appropriate for other than overflow SJESP calls
- SJG must not bear any of the costs for such reimbursement.

5. Recommendations

15. Reassess and expand the definition of what constitutes enrollment, marketing, and development assistance to affiliates, and substantially improve controls over its provision.

SJI/SJG have taken too narrow a view of what types of assistance may be provided and who may provide it to RCBSs. The RCBSs have paid for the assistance they have received; therefore, utility customers have not subsidized it. This error, however, has resulted in significant advantage to SJE and SJESP, given the failure to make similar services available to other market participants. There needs to be a focused, senior effort to better define the scope of activities covered by this provision. These effort should be led by the compliance director whose creation Liberty recommended in Chapter III of this report. Following the completion of this effort, there should be revised guidance issued to SJG and RCBS personnel. Pending the verification that the

Company has brought this area under better control; *i.e.*, at least until the next EDECA audit, explicit compliance director and CEO authorization should be required prior to any involvement of SJG or affiliates performing SJG activities in marketing and business development work for RCBSs.

The Company must also begin immediately to conform to the obligation that it make such support and service activities available to others by posting in a specially-designated portion of the SJG web site. The SJI web site should contain a link to this portion of the SJG web site. Posting of availability should occur not later than the time of the recommended, required authorization for such activities.

16. Provide supplemental guidance on the bonus program for SJG employees who handle overflow SJESP telephone contacts.

The transition of the appliance service business to SJESP has understandably created the need for a number of temporary services from SJG, some of which may impose pressures that militate against permanent use of utility personnel. There is greater than ordinary potential for overstepping limits in this situation. That potential merits supplemental instruction to call-center personnel on the need to limit the selling of additional SJESP services plans to calls that come on an overflow basis to SJG from already-existing SJESP customers.

N. Customer Advice or Assistance

1. Statement of Applicable Requirements

Section 14:4-5.3(n) of the Standards provides that:

Provided it is in compliance with these standards, and subject to the provisions of N.J.A.C. 14:4-5.4(g), an electric and/or gas public utility may offer or provide customers advice or assistance with regard to a related competitive business segment of its public utility holding company and/or other product and/or service providers upon the unsolicited request of the customer, so long as such advice or assistance is provided with regard to other competitors on a non-discriminatory basis.

2. Summary of Audit Activities

These provisions assure equal treatment of all providers of goods and services offered by an RCBS of the PUHC, and that the public is made aware of the existence of alternative suppliers of utility-related products and services or of products and services of any related competitive business segment of its holding company. Liberty applied the following criteria in examining performance under this standard:

- Regular customer communications should not offer advice or assistance about any RCBS of its holding company.
- The utility compliance plan should offer employees explicit instructions that: (a) limit them to providing such advice or assistance to cases where it is solicited by customers, and (b) instruct them that such advice must be provided with regard to other competitors on a non-discriminatory basis.

Liberty reviewed the utility's website, materials that it provides in response to customer inquiries about Energy Choice, and the compliance plan with regard to this portion of the Standards.

3. Findings

Liberty examined the information provided by SJG when a customer requests information about *Energy Choice*. The package includes a one-page description of the program, a customer-consent form, a savings calculation form, the *New Jersey Energy Choice Shopping Guide*, and a list of BPU-approved suppliers. The information contains no mention of any affiliate and no direct or indirect statement or suggestion that any affiliate provides relevant services or would offer the customer any advantage over non-affiliated providers. The separate lists of approved residential and commercial suppliers that SJG provided during the audit period followed alphabetical order, and did not highlight or emphasize the listed SJG affiliate, SJE, in any way.

One gains access to the SJG webpage from the SJI home page, at www.sjindustries.com. The parent's home page consists predominantly of links to six affiliates, of which SJG is the first. These links dominate the page visually, with each having similar design, size, and graphics. Across the top of the page, there is a series of buttons for a variety of general corporate information of various categories: investor, stock quote, media, employment, and company contact. The main SJG page does not highlight customer choice. It consists of simple graphics and a series of buttons, which consist of:

- Customer Information
- Media Information
- Contact Us
- Switch to Natural Gas
- Commercial Customers
- Employment Opportunities
- South Jersey Industries (no more than a link back to the parent's home page)

One must click the *Customer Information* button, and then scroll down to the table of contents, which lists *Energy Choice* as the third topic. The narrative under that subject invites customers to contact SJG for information about supplier choice. It makes no reference to any BPU site, nor does it list third-party suppliers. It does note that such a list is among the information that SJG will supply on contact to its customer service department. Highlighting the SJE button on the SJI homepage brings up a statement that residential customers can save money through a convenient on-line sign up process. The button on the SJE page that used to provide for sign-up has been deactivated, given SJE's decision in the Fall of 2004 to cease soliciting new customers.

Liberty reviewed the SJG Compliance Plan. The plan recites this provision, and notes that SJG implemented a communications plan (addressed earlier in this Chapter) to assure awareness of applicable rules. The current version of the plan contains an operating procedure that describes permitted and prohibited communications by SJG customer care representatives when handling customer calls. The procedure specifically allows a customer care representative to respond to questions about its affiliate appliance service business, provided that there is no recommendation or implication of preferential treatment. There is no statement about the duty to respond similarly to requests for information about other, unaffiliated competitors.

Another example of permitted conduct is advising a customer that SJE is an affiliated company. The procedure does not make clear that the only time that this statement may occur is when a customer specifically asks for such information. In addition, the guidance given to customer care representatives, when asked by a customer whether he or she can recommend SJE as an alternative supplier, states that SJG is not permitted to make such a recommendation, and instructs the representatives to provide a list of available third-party suppliers.

4. Conclusions

- a. The SJG Compliance Plan addresses Section 5.3(n), but does not provide sufficiently clear direction to employees regarding what advice about RCBSs can be provided to customers, and how similar advice can be provided with regard to competitors.**

Customer care operating procedures fail to make clear that SJG personnel should treat requests for recommendations of its affiliates in exactly the same manner as they treat such requests for recommendations of unaffiliated providers. The ambiguous wording of the procedures supports an inference that customer-care personnel can note, the affiliation of SJE or SJESP with SJG even in the absence of a customer question on that specific point.

- b. The listing of third party suppliers provided in response to customer requests does not highlight any supplier, and meets the requirements of this section of the Standards, as well as Section 14:4-5.4(c).**

5. Recommendations

- 17. Revise customer-care procedures either to prohibit the provision of advice about an RCBS or, alternatively, to provide a narrative description making clear to employees the occasions on which advice can be offered to customers about affiliates; if such advice is to be permitted, the plan must also specify how employees are to make similar advice available regarding other market participants.**

A technical change to the procedures, which the Compliance Plan incorporates, is needed to make clear that SJG personnel should must treat requests for recommendations of its affiliates in exactly the same manner as they treat such requests for recommendations of unaffiliated providers. Specifically, the needed change must also advise representatives that they may not recommend an affiliate in the absence of a specific customer request of question soliciting such a recommendation.

O. Posting Discounts, Rebates, and Waivers

1. Statement of Applicable Requirements

Section 14:4-5.3(o) of the Standards provides that:

If a discount, rebate, or other waiver of any charge, penalty, or fee associated with products and/or services provided by an electric and/or gas public utility is offered to its PUHC or a related competitive business segment of its public utility

holding company, the electric an/or gas public utility shall provide the following information within 24 hours of the time of the transaction, via a public posting:

- 1. The name of its PUHC or related competitive business segment of its public utility holding company involved in the transaction;*
- 2. The rate charged;*
- 3. The maximum rate;*
- 4. The time period for which the discount, rebate, or waiver applies;*
- 5. The quantities involved in the transaction;*
- 6. The delivery points involved in the transaction;*
- 7. Any conditions or requirements applicable to the discount, rebate or waiver, and a documentation of the cost differential underlying the discount as required in (d) or (e) above; and*
- 8. Procedures by which a non-affiliated entity may request a comparable offer.*

2. Summary of Audit Activities

These provisions ensure that the details of any discount, rebate, or other waiver of any charge provided by a utility to RCBSs of its PUHC are made available by a public posting to non-affiliated entities. The posting must include information on how a non-affiliate can request a comparable offer.

The criteria that Liberty used to examine performance under this standard were:

- The utility compliance plan should offer employees explicit instructions that address compliance with this provision
- Any discounts, rebates, or waivers offered should be posted as required.

Liberty asked for information about any discounts, rebates or waivers offered by the utility. Liberty requested copies of any posting required to comply with this section, and also searched the Company's website for any relevant postings.

Liberty also reviewed the utility compliance plan to examine the Company's intended method of complying with this section of the Standards.

3. Findings

In its response to the data request, SJG indicated that it did not offer any form of fee waivers or discounts from SJG to any affiliate. If it did not, then posting would not be relevant. The Compliance Plan restates this section, and notes that tariff issues fall within the responsibility of the Rates and Regulatory Affairs Department. This department issued an October 2004 memorandum asking that all transactions involving a discount be reported to it for prior approval, and noting that it would make interpretations of tariff provisions.

4. Conclusions

- a. SJG did not offer a discount or waiver to any RCBS of SJI during the audit period to which Section 14:4-5.3(o) would apply.**
- b. The Compliance Plan adequately specifies who has responsibility for enforcing this provision and how it will be enforced.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

P. Information Retention for Discounts, Rebates, and Waivers

1. Statement of Applicable Requirements

Section 14:4-5.3(p) of the Standards provides that:

An electric and/or gas public utility that provides its PUHC or a related competitive business segment of its public utility holding company a discounted rate, rebate, or other waiver of a charge, penalty or fee associated with services offered by the electric and/or gas public utility shall maintain, in compliance with N.J.A.C. 14:4-5.2 or longer if required by another government agency, for each billing period, the following information:

The standard goes on to recite seven categories of information that must be retained.

2. Summary of Audit Activities

These provisions ensure that the utility maintain adequate documentation regarding details of any discount, rebate, or other waiver of any charge provided by a utility to its PUHC or to RCBSs of its PUHC.

Liberty's criteria and audit activities were the same as those set forth for Section 14:4-5.3(o).

3. Findings

Liberty's findings are the same as those set forth for Section 14:4-5.3(o).

4. Conclusions

- a. SJG did not offer a discount or waiver to any RCBS of the holding company during the audit period to which Section 14:4-5.3(p) would apply.**
- b. The Compliance Plan adequately specifies who has responsibility for enforcing this provision and how it will be enforced.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

Q. Compliance with FERC Record Keeping Requirements

1. Statement of Applicable Requirements

Section 14:4-5.3(q) of the Standards provides that:

All records maintained pursuant to the standards in (o) and (p) above shall also conform to FERC rules where applicable.

2. Summary of Audit Activities

This provision requires that records maintained regarding discounts, waivers and rebates offered by a utility to its PUHC or to an RCBS of its RCBS conform to FERC rules. Liberty's audit activities were the same as those set forth for Section 14:4-5.3(o).

3. Findings

As the Company has offered no discounts, rebates, or waivers to any customer, including its PUHC and RCBSs of its PUHC, during the audit period, Section 14:4-5.3(q) is not applicable. The Compliance Plan restates this section, and notes that tariff issues fall within the responsibility of the rates and regulatory affairs department. This department issues an October 2004 memorandum asking that all transactions involving a discount be reported to it for prior approval, and noting that it would make interpretations of tariff provisions.

4. Conclusions

- a. SJG did not offer a discount or waiver to any RCBS of the holding company during the audit period to which Section 14:4-5.3(q) would apply.**
- b. The Compliance Plan specifies who has responsibility for enforcing this provision and how it will be enforced.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

VI. Information Disclosure Standards (Section 14:4-5.4)

Section 14:4-5.4 of the Standards applies to interactions between a utility and an RCBS of its holding company or the holding company itself if it offers or provides competitive services to retail customers in New Jersey. These standards do not apply, however, in cases where an internal RCBS exists within the utility itself and where there are transactions between the utility and such an RCBS. Separate standards, which Chapter V of this report addresses, apply to interactions between utilities and their internal RCBSs.

A. Providing Customer Proprietary Information

1. Statement of Applicable Requirements

Section 14:4-5.4(a) of the Standards provides that:

An electric and/or gas utility may provide individual proprietary information to its PUHC or a related competitive business segment of its public holding company only with the prior affirmative customer written consent or as otherwise authorized by the Board and only if it is provided to unaffiliated entities on a non-discriminatory basis.

2. Summary of Audit Activities

These provisions provide protection to customers and competitors by preventing affiliate exploitation of information and data generated by the public utility. The holding company and its RCBSs could gain competitive advantage by:

- Inappropriately sharing of customer specific information
- Using information gained through the operation of the utility system to gain competitive advantage in identifying market opportunities or problems
- Using non-public information provided to the public utility by unaffiliated suppliers to gain competitive advantage
- Inappropriately using or exclusively exchanging proprietary data to preclude unaffiliated suppliers from obtaining information available to the PUHC and its related competitive business segment.

The criteria that Liberty applied in examining performance under this standard were:

- The utility should have adequate methods for controlling the release of customer information in accord with the standard
- The utility compliance plan should adequately address employee obligations under this standard.

In its initial review of customer proprietary information, Liberty sought via data requests and interviews to determine if the utility released customer proprietary information to either a holding company or RCBS during the audit period. Liberty then sought to determine if all customer-proprietary information releases that had occurred came after proper customer authorization or other approval of by the BPU. Liberty also requested information regarding any

formal or informal complaints concerning the use or release of customer proprietary information that occurred during the audit period.

Liberty also reviewed utility customer-service processes to ensure that adequate methods existed to control access and protect customer proprietary information from inappropriate disclosure or access. In particular, Liberty reviewed training material for customer service personnel and customer service personnel aids, along with controls on access to customer information.

3. Findings

Sections V.B. and VI I.F. of this report discusses controls that SJG applies to requests by affiliates for access to customer information databases. The IS Department processes all such requests and uses forms that require authorization by SGJ for the extraction of any data that the utility maintains concerning its customers. IS has responsibility for developing extraction processes that limit data appropriately and for controlling access to customer data. IS provides this control primarily through password protection. SJG reported that it limited audit-period releases of customer-proprietary information to cases where it received an enrollment request from a third-party supplier, or where it received from a third-party supplier a customer authorization for providing consumption histories. The SJG Vice President of Customer Service reported to Liberty that she is unaware of any audit-period unauthorized releases of customer information.

A contractor, Third Wave Services, provides marketing database services under a three-year agreement, first signed in February 2000. This contract called for payments in the following amounts, to construct the database and then to allow for hosting, training, support, and storage:

- Year 1: \$xxxxxx
- Year 2: \$xxxxxx
- Year 3: \$xxxxxx

SJI renewed the agreement in August 2002. The base annual costs for continuing services, which SJI pays, rose only moderately, to \$xxxxxx per year. SJG and SJE used these services through March 2003, at which time SJI amended the agreement. Through this time, the contract documentation did not address in any detail the need for isolation of the customer information in the SJG database.

The March 2003 amendment allowed modification of the database to add a separate, password-protected SJESP database (\$) and to increase the functionality of all three databases (\$). The contractor would provide three separate databases for SJG, SJE, and SJESP, with password protection to isolate them from each other. SJESP paid for the addition of its database; all three shared evenly the cost of the increased functionality. SJG and SJE also made small payments during the audit period for special programming or reports related to their individual databases. The information supplied by SJG's information systems department in February 2003 indicated the submission to the contractor of separate database files for SJG, SJE and SJESP (still called the appliance service business at that time).

The current Compliance Plan recites this provision of the Standards, and notes the completion of a communications program to inform SJG departments affected by it. The plan includes a customer care operating procedure that precludes the sharing of customer information without approval. The guidance available to employees largely restates the general rule of the standards, but provides no specific procedure for determining what constitutes customer proprietary information or for assuring that any release of such information takes place only as allowed by the standards. SJG reported to Liberty that it considers “all customer specific information” to be confidential, but maintains no list of what falls within that category.

Section V.M. of this report discusses the access that SJESP gained to a list of SJG’s ASB *Service Sentry* customers from the Third Wave database, while SJG still ran that business (*i.e.*, prior to September 2004). SJESP used that list to generate a direct mail list for equipment installation services that SJESP was performing.

4. Conclusions

- a. **SJG appropriately limited outside release of customer proprietary information during the audit period to cases where there was prior authorization of the customer.**
- b. **SJG applied adequate processes to protect customer proprietary information from inappropriate internal release during the audit period.**

There was a controlled process for gaining access to databases including customer information. SJG applied them in a manner that provided for proper authorization and limitation in the information ultimately provided.

- c. **SJG nevertheless did make available to an RCBS (SJESP) utility customer data for use in creating a direct mail list.**
- d. **Existing guidance to employees does not provide sufficient definition of what constitutes customer proprietary information or how to handle requests for its release.**

The policy of deeming all “all customer specific information” is very general, and not particularly helpful in making clear to employees what is subject to release.

- e. **The *Third Wave* databases contain appropriate separation, but it is not clear that the contractor has been given sufficient information about controlling access to them.**

The contractor has received sufficient instruction to assure that SJG and affiliates operate the systems it supports with proper information separation. However, the agreements and supporting documentation that Liberty has seen do not provide the contractor with clear guidance on assuring that its support work does not occasion an improper release of information.

5. Recommendations

18. Provide a more comprehensive description of what constitutes *customer-proprietary information* subject to protection under Section 14:4-5.4(a).

Guidance to employees in the Compliance Plan and underlying procedures needs to make clear what kinds of information fall within the disclosure limits.

SJESP's access to SJG information about customers taking appliance services from the utility was inappropriate, but not capable of recurrence given SJG's exit from that business. Sections V.M. and VI.A. of this report addresses the aspects of that situation that have continuing relevance.

19. Instruct contractors involved in creating, operating, or supporting systems containing customer-specific information of the need for preserving separation of access by affiliates.

SJG has performed well in assuring that contractors perform their work in ways that will allow SJG and affiliates to restrict data access appropriately. However, those contractors have reason to see their clients as including not just SJG, but other SJI entities. They need to understand that their work with respect to these databases does not present an opportunity for information to pass inappropriately to and RCBS. A letter summarizing the requirements that apply to SJI and its affiliates and emphasizing the materiality of the contractor's operating in a manner that keeps information separate is sufficient.

B. Providing Other Non-Public Information

1. Statement of Applicable Requirements

Section 14:4-5.4(b) of the Standards provides that:

An electric and/or gas public utility shall make available non-customer specific non-public information acquired as a result of operating the public utility's distribution system, including information about an electric and/or gas public utility's natural gas or electricity purchases, sales, or operations or about an electric and/or gas public utility's gas-related goods or services, electricity-related goods or services, to a related competitive business segment of its public utility holding company only if the electric and/or gas public utility makes such information available, via a public posting, to all other service providers on a non-discriminatory basis, and keeps the information open to public inspection.

1. An electric or gas public utility is permitted to exchange proprietary information on an exclusive basis with its PUHC or a related competitive business segment of its public utility holding company, provided it is necessary to exchange this information in the provision of the corporate support service permitted by N.J.A.C. 14:4-5.5(i) and (j).

2. The PUHC's or related competitive business segment's use of such proprietary information is limited to its use in conjunction with the permitted corporate support services, and is not permitted for other use.

2. Summary of Audit Activities

These provisions provide protection to competitors by preventing affiliate exploitation of information and data generated by the public utility. The PUHC and the related competitive business segments could gain competitive advantage in the following manner:

- Utilizing information gathered through the operation of the utility system to gain competitive advantage in identifying market opportunities or problems
- Inappropriate use or exclusive exchange of proprietary data to preclude unaffiliated suppliers from obtaining information available to the PUHC and its related competitive business segment.

The criteria that Liberty applied in examining performance under this standard were:

- The utility compliance plan should adequately address employee obligations under this standard
- Any release of covered information should meet the posting and continuous availability requirements of the standard.

Liberty sought to determine if the holding company or a holding company RCBS received non-customer-specific information acquired by the utility in the operation of its distribution system, and whether it was then made available to other service providers via a public posting. To the extent that non-specific customer information resides on a website that is readily accessible by competitors, Liberty believes that the Company would meet the requirements of the standard. Liberty reviewed the utility's planning processes to determine if this non-specific information was acquired by any RCBS during the planning process, and reviewed the Company's practices concerning the use of non-specific customer information.

As to the exclusive exchange of proprietary information between the utility and its holding company or an holding company RCBS necessary for corporate support services, Liberty sought to identify whether such information had been exchanged. To the extent that such data are required for the provision of support service pursuant to and permitted by N.J.A.C. 14.4-5.5(i) and (j) then it would meet the requirement.

3. Findings

The current Compliance Plan recites this provision of the Standards, and notes the completion of a communications program to inform SJG departments affected by it. The plan includes a customer care operating procedure that precludes the sharing of non-customer specific information. As is true for customer-proprietary information, there is no procedure identifying the kind of information covered or for assuring that release occurs only as permitted by the standards. SJG reported to Liberty that it made no release of such information to affiliates during the audit period.

4. Conclusions

- a. The Compliance Plan addresses Section 14:4-5.4(b) of the Standards, but fails to give adequate procedural guidance for its application.

5. Recommendations

20. Provide a more comprehensive description of what constitutes *other non-public* information subject to protection under Section 14:4-5.4(b).

C. Providing Lists of Generation or Gas Service Providers

1. Statement of Applicable Requirements

Section 14:4-5.4(c) of the Standards provides that:

When an electric and/or gas public utility makes available a list of electric generation and/or gas service suppliers (suppliers), said list shall only contain those suppliers who are duly licensed by the Board and comply with the electric and/or gas public utility's Board-approved tariff to operate on its distribution system. Said list shall be maintained in alphabetical order, and not highlight or otherwise promote any particular supplier.

2. Summary of Audit Activities

This provision limits utility-provided lists of competitive suppliers of electric generation and gas service to those licensed by the Board and it precludes any form of emphasis on a particular supplier on such lists. The criteria that Liberty applied in evaluating utility performance under this standard were:

- Supplier lists should contain all those licensed by the Board and only those licensed
- There should be no emphasis by location or print and other identification features on any supplier on the list
- The utility compliance plan should adequately address the release requirements of this provision.

Sections 14:4-5.3(n), 14:4-5.4(c), 14:4-5.4(f), and 14:4-5.4(g) are related. Liberty's audit activities were the same as those set forth for Section 14:4-5.3(n).

3. Findings

The Compliance plan recites this provision. An October 2004 memorandum to customer car center, transportation, and rates management personnel incorporated a specific procedure for handling supplier lists. The procedure provides for the transportation department, which manages relations with all third-party suppliers, including SJE, to manage additions to the lists maintained for residential, commercial, and industrial customers. The procedure incorporates the provision's requirements for inclusion on the list, alphabetized order of names, and the preclusion of any highlighting or promotion of any supplier.

4. Conclusions

- a. The supplier lists that SJG used during the audit period complied with this provision.
- b. The Compliance Plan and SJG procedures adequately address the requirements of Section 14:4-5.4(c) of the Standards.

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

D. Providing Affiliates Information Concerning Unaffiliated Suppliers

1. Statement of Applicable Requirements

Section 14:4-5.4(d) of the Standards provides that:

An electric and/or gas public utility may provide non-public information and data which have been received from unaffiliated suppliers to its PUHC or a related competitive business segment of its public utility holding company or other non-affiliated entities only if the electric and/or gas public utility first obtains written affirmative authorization to do so from said unaffiliated supplier.

2. Summary of Audit Activities

This provision provides protection to competitors by preventing exploitation of confidential non-public information and data provided by an unaffiliated supplier to the utility. The PUHC and related competitive business segments could gain competitive advantage by:

- Using non-public information provided to the public utility by unaffiliated suppliers to improve the holding company and RCBS understanding of market conditions
- Restricting the use of non-public information provided by an unaffiliated supplier to only the PUHC or related competitive business segment.

Liberty applied the following criteria in examining this provision of the Standards:

- Non-public information and data received from unaffiliated suppliers by the electric or gas public utility can be provided to either the holding company or a related RCBS only if the public Utility is authorized by the non-affiliated supplier to release the information
- There should have been no provision of information received from unaffiliated suppliers absent written permission
- The utility compliance plan should adequately address the release requirements of this provision.

Liberty first determined if non-affiliated information and data are shared by the utility with the holding company or any holding company RCBS. If the information and data were shared with the holding company or RCBS, then Liberty would then review the unaffiliated supplier's written authorization for release of the information. To the extent that a signed release was provided, Liberty would then consider this provision met.

3. Findings

During the audit period, SJG did not release any information or data from unaffiliated suppliers to an RCBS. The current Compliance Plan recites this provision of the Standards, and notes the completion of a communications program to inform SJG departments affected by it. It also includes a customer care operating procedure that prohibits providing leads or soliciting business for its retail competitive business services. The plan does not proscribe the provision of information about competitors to affiliates. There is similarly no proscription in procedures applicable to the transportation department, which manages relationships with unaffiliated energy marketers.

4. Conclusions

- a. During the period of the audit, SJG did not provide or release non-public information subject to 14:4-5.4(d) from any unaffiliated supplier to affiliates.**
- b. The Compliance Plan and supporting SJG procedures generally addresses Section 14:4-5.4(b) of the Standards adequately.**
- c. Operating procedures fail to incorporate a prohibition on providing affiliates with information about unaffiliated energy marketers.**

5. Recommendations

- 21. Amend the operating procedures to include a prohibition on providing affiliates with information about unaffiliated energy marketers.**

E. Soliciting Release of Information Concerning Unaffiliated Suppliers

1. Statement of Applicable Requirements

Section 14:4-5.4(e) of the Standards provides that:

An electric and/or gas public utility shall not solicit the release of such information exclusively to its PUHC or a related competitive business of its public utility holding company in an effort to keep such information from other unaffiliated entities.

2. Summary of Audit Activities

This provision provides protection to competitors by preventing a utility from requesting asymmetric access to information requested from unaffiliated suppliers. Liberty first determined if non-affiliated information and data are shared by the utility with its holding company or holding company RCBS. If so, Liberty would then determine if the information and data were provided to other suppliers pursuant to the requirements of this provision. The solicitation could not be exclusively for the holding company or holding company RCBS in an effort to prevent distribution to nonaffiliated suppliers. To the extent there were any such solicitations, Liberty would review each to determine if it were designed to limit the information distribution.

3. Findings

During the audit period, SJG did not solicit non-public data or information from unaffiliated suppliers within its certified territory for release to an affiliate, nor did it release any such information. The current Compliance Plan recites this provision of the Standards, and notes the completion of a communications program to inform SJG departments affected by it. The plan contains a customer care operating procedure that communicates the prohibition on asking customers for information to be passed along exclusively to an RCBS.

4. Conclusions

- a. During the audit period SJG did not solicit unaffiliated supplier non-public information for release to affiliated entities.**
- b. The Compliance Plan adequately addresses Section 14:4-5.4(b) of the Standards.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

F. Highlighting Affiliates in Lists of Providers

1. Statement of Applicable Requirements

Section 14:4-5.4(f) of the Standards provides that:

Except upon request by a customer or as authorized in (c) above or otherwise by the Board, an electric and/or gas public utility shall not provide its customers with any list of product and/or service providers, which highlights or otherwise identifies its PUHC or a related competitive business segment of its public utility holding company, regardless of whether such list also includes the names of unaffiliated entities.

2. Summary of Audit Activities

Sections 14:4-5.3(n), 14:4-5.4(c), 14:4-5.4(f), and 14:4-5.4(g) are related. Liberty's audit activities were the same as those set forth for Section 14:4-5.3(n).

3. Findings

Liberty's findings are the same as those set forth for Section 14:4-5.3(n).

4. Conclusions

Liberty's conclusions are the same as those set forth for Section 14:4-5.3(n).

5. Recommendations

Liberty's recommendations are the same as those set forth for Section 14:4-5.3(n).

G. Supplementing Information About Affiliated Providers

1. Statement of Applicable Requirements

Section 14:4-5.4(g) of the Standards provides that:

If a customer requests information about any affiliated product and/or service provider, the electric and/or gas public utility may acknowledge that such affiliated product and/or service provider exists, but shall provide no additional information unless it provides a list of all providers of gas-related, electricity-related, or other utility-related products and/or services in business in its service territory, including the related competitive business segment of its public utility holding company.

- 1. Any such list shall include all suppliers licensed by the Board.*
- 2. Where maintaining such list would be unduly burdensome due to the number of service providers, the electric and/or gas public utility shall not provide a list and may direct the customer to a generally available listing of service providers, for example, the Board, the telephone directory or Internet.*

2. Summary of Audit Activities

Sections 14:4-5.3(n), 14:4-5.4(c), 14:4-5.4(f), and 14:4-5.4(g) are related. Liberty's audit activities were the same as those set forth for Section 14:4-5.3(n).

3. Findings

Liberty's findings are the same as those set forth for Section 14:4-5.3(n).

4. Conclusions

Liberty's conclusions are the same as those set forth for Section 14:4-5.3(n).

5. Recommendations

Liberty's recommendations are the same as those set forth for Section 14:4-5.3(n).

H. Record Keeping Concerning Transactions with Affiliates

1. Statement of Applicable Requirements

Section 14:4-5.4(h) of the Standards provides that:

An electric and/or gas public utility shall maintain complete and accurate records, documenting all tariffed and non-tariffed transactions with its PUHC and a related competitive business segment of its public utility holding company, including but not limited to, all waivers of tariffed or contract provisions.

2. Summary of Audit Activities

These provisions require a utility to keep complete and accurate records of all transactions it has with its holding companies and related RCBSs. During transaction testing, and during other work sessions as well, Liberty reviewed the available documentation for numerous transactions

between the utility and its affiliates. In addition, Liberty requested all contracts between the regulated and unregulated affiliates and reviewed the contracts it received.

The criteria Liberty applied in examining performance under this standard are set forth in the chapter of this report that addresses transaction testing.

3. Findings

Liberty found that SJG was able to provide requested documentation. The current Compliance Plan recites this provision of the Standards, and notes that the general accounting department has responsibility for implementation.

4. Conclusions

- a. **The willingness and ability of SJG, its holding company, and affiliates to provide all requested agreements and transaction documents during Liberty's transaction testing activities demonstrated compliance with the provisions of Section 14:4-5.4(h) of the Standards.**
- b. **The Compliance Plan adequately addresses the requirements of Section 14:4-5.4(h) of the Standards.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

I. Record Retention Requirements for Transactions with Affiliates

1. Statement of Applicable Requirements

Section 14:4-5.4(i) of the Standards provides that:

An electric and/or gas public utility shall maintain such records in compliance with the time frame required by N.J.A.C. 14:5-5.2 or longer if another government agency so requires.

2. Summary of Audit Activities

These provisions require that the records of transactions between the utility and its holding company or holding company RCBSs be maintained in accordance with the period specified in N.J.A.C. 14:5-5.2.

3. Findings

Liberty's transaction testing produced no case where transaction documentation was unavailable because of a failure to retain it. The current Compliance Plan recites this provision of the Standards, and notes that the general accounting department has responsibility for implementation.

4. Conclusions

- a. SJG provides adequately for the retention of records of transactions involving it and its holding company or holding company RCBSs.**
- b. The Compliance Plan adequately addresses the requirements of Section 14:4-5.4(i) of the Standards.**

5. Recommendations

Liberty has no recommendations regarding this provision of the Standards.

J. Inspection of Records

1. Statement of Applicable Requirements

Section 14:4-5.4(j) of the Standards provides that:

An electric and/or gas public utility shall make such records available for Board and/or RA review upon 72 hours' notice, or at a time mutually agreeable to the electric and/or gas public utility and the Board and/or RA.

2. Summary of Audit Activities

These provisions require that transaction records be made available for BPU and Ratepayer Advocate review upon 72 hours notice. During conduct of its audit, Liberty sought access to records and documents pertaining to transactions involving the utility, holding company, and holding company RCBSs.

3. Findings

Liberty found that the companies were able to produce the records and documents as required during the audit. Liberty did not gain from any involved party any evidence of a failure to produce requested records. The current Compliance Plan recites this provision of the Standards, and notes that the general accounting department has responsibility for implementation.

4. Conclusions

- a. SJG was in compliance with 14:4-5.4(j).**
- b. The Compliance Plan adequately addresses the requirements of Section 14:4-5.4(j) of the Standards.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

K. Bid and Contract Records

1. Statement of Applicable Requirements

Section 14:4-5.4(k) of the Standards provides that:

An electric and/or gas public utility shall maintain a record of all contracts and related bids for the provision of work, products and/or services to and from the electric and/or gas public utility to and from the PUHC or related competitive business segments of its public utility holding company in compliance with N.J.A.C. 14:5-5.2 or longer if another government agency so requires.

2. Summary of Audit Activities

These provisions require that the utility maintain records of all contracts with the holding company and holding company RCBSs in accordance with N.J.A.C. 14:5-5.2.

During transaction testing, and during other work sessions as well, Liberty reviewed the available documentation for numerous transactions between the utility and its affiliates. In addition, Liberty requested all contracts between the utility and non-utility affiliates of SJI, and reviewed the contracts it received.

Liberty also sought to determine the utility's practices for retaining the documents required by this provision.

3. Findings

There are procedures that provide for the retention of transaction records. During transaction testing, SJG was able to supply all the agreements that Liberty requested. The current Compliance Plan recites this provision of the Standards, and notes that the corporate counsel has the responsibility to retain contracts, and the materials management department has the responsibility to retain bids. The corporate counsel issued an October 2004 memorandum requesting that all contracts be reported to his department for approval, and that all bids be forwarded for retention in accord with NJAC 14:5-5.2.

4. Conclusions

- a. SJG's practices were sufficient to assure retention of all contract information requested as part of transaction testing.**
- b. The Compliance Plan adequately addresses the requirements of Section 14:4-5.4(k) of the Standards.**

5. Recommendations

Liberty has no recommendations with respect to this provision of the Standards.

VII. Separation Standards (Section 14:4-5.5)

Section 14:4-5.5 of the Standards applies to interactions between a utility and an RCBS of its holding company or the holding company itself if it offers or provides competitive services to retail customers in New Jersey. These standards do not apply, however, in cases where an internal RCBS exists within the utility itself and where there are transactions between the utility and such an RCBS. Separate standards, which Chapter V of this report addresses, apply to interactions between utilities and their internal RCBSs.

A. Separate Corporate Entities

1. Statement of Applicable Requirements

Section 14:4-5.5(a) of the Standards provides that:

An electric and/or gas public utility, its PUHC and related competitive business segments of its public utility holding company shall be separate corporate entities.

2. Summary of Audit Activities

These provisions require that the utility, its PUHC, and the non-regulated RCBSs of the holding company be separate corporate entities. The criterion that Liberty employed in examining compliance with this standard was:

- The utility should exist as a legal entity that is separate and distinct from its holding company and any RCBS of its holding company.

Liberty considered relevant filings with the Securities and Exchange Commission, organization charts, a variety of data requests and interview results to assess whether there existed the required corporate separation between the utility, on the one hand, and any holding company or holding company RCBSs, on the other hand.

3. Findings

Liberty found that SJG existed and operated as a distinct corporate entity during the audit period, as it has historically, and as it will most likely do in the future. The current Compliance Plan recites this provision of the Standards.

4. Conclusions

- a. The SJI/SJG structure and operation complied with this provision of the standards during the audit period.
- b. The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(a) of the Standards.

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

B. Separate Books and Records

1. Statement of Applicable Requirements

Section 14:4-5.5(b) of the Standards provides that:

An electric and/or gas public utility and related competitive business segments of its public utility holding company shall keep separate books and records.

2. Summary of Audit Activities

This provision requires that the holding company keep separate books and records for the regulated utility and for its non-regulated affiliates. The criterion that Liberty applied in examining compliance with this standard was:

- Whether the utility books and records are fully separate and distinct from those of the holding company and any holding company RCBS.

Liberty conducted on-site interviews to review the company books and records.

3. Findings

Liberty found that SJI maintains separate books and records for the required entities. The current Compliance Plan recites this provision of the Standards, and notes that the general accounting department has responsibility for implementation.

4. Conclusions

- a. SJI/SJG complied with the provisions of Section 14:4-5.5(b) during the audit period.
- b. The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(b) of the Standards.

5. Recommendations

Liberty has no recommendations with respect to this provision of the Standards.

C. Conformity of Books and Records with USOA

1. Statement of Applicable Requirements

Section 14:4-5.5(c) of the Standards provides that:

Electric and/or gas public utilities' books and records shall be kept in accordance with applicable Uniform System of Accounts (USOA).

2. Summary of Audit Activities

This provision requires that the utility maintain books and records in accordance with USOA. Liberty did not undertake a full-scale examination of conformity with each USOA requirement. However, Liberty did conduct an overall review of compliance, and, during its transaction testing work, which its companion *Cost Allocations and Affiliate Relationships* report addresses, did seek to determine whether affiliate transaction record keeping demonstrated substantial

compliance with all USOA requirements applicable to the transactions tested and the documents being examined as part of that testing. Liberty also addressed *Accounting and Controls*, which form a separate section of its companion reporting on the results of its assessment of management and operations.

3. Findings

The SJG chart of accounts is consistent with USOA. The current Compliance Plan recites this provision of the Standards, and notes that the general accounting department has responsibility for implementation.

4. Conclusions

- a. SJG complied with the requirements of Section 14:4-5.5(c) during the audit period.**
- b. The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(c) of the Standards.**

5. Recommendations

Liberty has no recommendations with respect to this requirement.

D. Availability of Books and Records for Board Examination

1. Statement of Applicable Requirements

Section 14:4-5.5(d) of the Standards provides that:

The books and records of its PUHC or a related competitive business segment of an electric and/or gas public utility's holding company engaged in transactions, interactions and relations with the electric or gas public utility shall be open for examination by the Board.

2. Summary of Audit Activities

This provision requires that the utility's holding company provide access to its books and records and to those of its non-regulated RCBSs. During the conduct of its audit, Liberty sought access to a host of records and documents pertaining to the utility, utility holding company and holding company RCBSs. The criterion that Liberty applied in examining compliance with this standard was:

- Whether all requests for information necessary to verify compliance with the standards subject to this audit produced substantially complete responses.

3. Findings

SJG provided substantially complete responses to all of Liberty's requests for information, whether through data requests, access to documents, or interviews. Liberty believes that the support shown for the audit was commendable, particularly given the relatively small size of SJI and the other substantial requirements it faced as this audit progressed, *e.g.*, Sarbanes Oxley Section 404 deadlines. Liberty believes that SJI has demonstrated a very strong willingness and

ability to make its books and records open for examination for compliance with the standards. The current Compliance Plan recites this provision of the Standards, and notes that the general accounting department has responsibility for implementation.

4. Conclusions

- a. All of SJI's entities and people complied with the requirements of Standards Section 14:4-5.5(d) in responding to Liberty's requests for information; they demonstrated in interviews and responses to data requests an especially cooperative and supportive attitude towards regulatory needs and objectives.**
- b. The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(d) of the Standards.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

E. Sharing of Space, Services, and Equipment

1. Statement of Applicable Requirements

Section 14:4-5.5(e) of the Standards provides that:

An electric and/or gas public utility shall not share office space, office equipment, services, and systems with a related competitive business segment of its public utility holding company, except to the extent appropriate to perform shared corporate support functions permitted under this subsection or as follows:

- 1. An electric and/or gas public utility may access the computer or information systems of a competitive related business segment of its PUHC or allow a related competitive business segment of its PUHC to access its computer or information systems, for purposes of the sharing of computer hardware and software systems and may share office space, office equipment, services and systems, provided adequate system protections are in place to prevent the accessing of information or data between the utility and its affiliate(s) which would be in violation of these standards.*
 - i. Prevention of unauthorized access to computer and information systems must be specifically addressed as part of an electric and/or gas public utility's compliance plan submitted pursuant to N.J.A.C. 14:4-5.7(b).*

2. Summary of Audit Activities

These provisions allow a utility and an RCBS of its PUHC to share office space, office equipment, services and systems only if:

- It is required as part of providing permitted shared corporate support functions, or

- Adequate system protections are in place to prevent accessing of data that would violate the Standards.

The effect of the two bulleted exceptions is generally to allow shared space, services, systems, and equipment, provided that security against data exchange is adequate. Given the breadth of this exception, Liberty applied the following criterion in examining performance under this standard:

- Whether, in cases where sharing is done, adequate measures are taken to prevent inappropriate information exchange.

Liberty requested information regarding the sharing of *Information Technology* services between the utility, its holding company, and holding company RCBSs. Liberty conducted an in-depth interview with personnel from the Information Technology Department and followed up with several data requests. In addition, Liberty reviewed the listing of databases and policies and procedures pertaining to IT security and data base access.

3. Findings

The following tables list the databases that Information Systems supports. The lists summarize controls on access. The databases fall into four major types:

- Operations systems used only for the benefit of SJG
- Administrative systems used for the benefit of SJG and Non-Utility Affiliates
- Operations systems used for the benefit of SJG and Non-Utility Affiliates
- Other systems used only for the benefit of Non-Utility Affiliates

Table VII-1. Operations Systems Used by SJG

System	Controlled	Affiliate Access
<i>Mainframe Based</i>		
Cash Processing	SJC Customer Care	None listed
Meter History	SJC Customer Care	None listed
Unbilled Revenue	No on-line access	None listed
Collection	SJC Customer Care	None listed
Service-Order Tracking	SJC Customer Care	None listed
Petty Cash/Suspended Accounts	SJC Customer Care	None listed
Miscellaneous Sales	No on-line access	None listed
<i>PC-Based</i>		
Gas Transportation EDI	No on-line access	Produces BPU-required reports for marketers
Computer Aided Design	SJG	None listed
Engineering Network Analysis	SJG	None listed
Gas Sales Tracking	SJG	None listed
Construction Order System	SJG	None listed
Leak Survey and Databases	SJG	None listed
Corrosion Protection	SJG	None listed
SCADA	SJG	None listed
METRETEK AMR	SJG	None listed
Construction Permit Checks	SJG	None listed
Rebates/HESB Administration	SJG	None listed
Field Collection	SJG	None listed
Inventory of Mains and Services	SJG	None listed

Divisional Cash Registers	SJG	None listed
Load Management Reporting	SJG	None listed
BPU E-Mail Complaints	SJG	None listed
Main Authorization Reporting	SJG	None listed
Service Record Card	SJG	None listed
Main Evaluation	SJG	None listed
Contractor Damages	SJG	None listed
Transportation Reporting	SJG	None listed
Street Department Work	SJG	None listed
Integrated Voice Response	SJG	None listed
Engineering Field Book	SJG	None listed

Table VII-2. Administrative Systems Used by SJG and Affiliates

System	Controlled	Affiliate Access
<i>Mainframe-Based</i>		
Stores Inventory	Not Controlled	SJESP
General Ledger	Yes	NOTE: Replaced by Lawson in 10/04
Payroll	Yes	NOTE: Replaced by Lawson in 10/04
Journal Entry	Yes	NOTE: Replaced by Lawson in 10/04
<i>PC-Based</i>		
Budget Preparation/Analysis	All entities	Access partitioned to own-company data
E-mail	All entities	Password protected
Stationery Stores	No	Used by all to make stationery orders
Records Center Database	Mgt Systems Dept.	Manages stored records for all entities
PC Hardware and Software	Mgt Systems Dept.	Tracks licensing for all entities
Lawson ERP	SJG	Used by affiliates only for exception time
SQL	By Product Line	Partitioned
Call Accounting	Mgt Systems Dept.	Tracks telephone calls for all entities
Sarbanes/Oxley Compliance	SJI Internal Audit	

Table VII-3. Operations Systems Used By SJG and Affiliates

System	Controlled	Affiliate Access
<i>Mainframe Based</i>		
Meter Reading	SJG Customer Care	Meter reading files prepared for Millennium
Dispatch-Order Tracking	SJC Customer Care	SJESP: own customer data for work orders
Automated Dispatching	SJC Customer Care	SJESP: own customer data for work orders
Work Measurement	No on-line access	SJESP for productivity reporting
Customer Billing Customer Budget	SJC Customer Care SJC Customer Care	SJE: own customer data SJESP: own customer data Millennium: update premise ID for meter reading
<i>PC-Based</i>		
Automated Dispatching	SJG and SJESP	Both use for dispatching

Table VII-4. Systems Used by Non-Utility Affiliates

<i>PC-Based</i>		
Solomon Accounting	Non-SJG	Non-utilities only use the system
SJE Billing	SJE	
Shareholder Records	SJI	Shareholder Records only has access
RADAR	SJR and SJE	No SJG access
Appliance Service Service Sentry	SJESP SJESP	Appliance Service Service Sentry

SJI applies a number of controls to assure that information from these databases remains available only to authorized users. They include the following:

- The IS department conducted a review of the Compliance Plan with all IS employees (last conducted in 2004)
- The IS vice president performs every two years an independent review of access to the CIS, the server, and the file transfer systems to ensure that the Compliance Plan is being followed
- There is password protection on all databases
- A company *Operating Procedure* (A12.1) requiring a work request for access, issued only after approval of the system or database owner and IS management
- Transmission of approved downloads are made to a secure subdirectory or to the e-mail address (passworded) of the approved requestor
- SJE is not permitted to make direct requests for information; they must come through and be approved by SJG's Transportation Department, which is responsible for managing relationships with all third-party marketers; SJE requests also require approval of the database/system owner and the vice president of IS
- All SJESP requests require approval of the database/system owner and the vice president of IS
- Databases accessible through the company network are password restricted to assure that affiliates do not have access to SJG data
- SJG uses intrusion detection software to monitor attempts at access to databases
- SJG CIS (Customer Information System) databases can only be accessed through designated terminals, the screens are password-protected, and only pre-identified inquiry types can be performed
- All passwords expire every six months
- The computer room is locked, and access is permitted only to authorized persons
- The network server area is locked after business hours
- The marketing services agreement with Third Wave Research (which provides SJG, SJE, and SJESP with prospect information) is password protected to partition the information of each and to prevent access to the information of the others.

The current Compliance Plan recites this provision and it notes that the Information Systems Department has responsibility for controlling access to computer and information systems. The plan does not specify how the department carries out that responsibility. The head of the department submitted an October 6, 2004 memorandum expressing his opinion that the mainframe, which includes SJG customer data is secured against access by affiliates through the use of password controls and a work-order process applicable to downloads and reports. He noted that work orders required his personal approval. The memorandum noted that his department was confirming adequate security through a review access to all data and information systems as part of Sarbanes Oxley Section 404 testing. He further noted that this testing would ensure access control and data security in accord with BPU standards.

4. Conclusions

- a. **There exist adequate controls to assure that computer and information system access is controlled in accord with the requirements of Section 14:4-5.5 (e) of the Standards.**
- b. **The work-request procedure is effective, but can be improved through the addition of certain acknowledgements.**

The procedure does not contain a section under which requestors certify their commitment:

- Not to pass information to persons outside those covered by the request
- Not to use the information for other purposes
- To retain the information received in a secure location.

- c. **The Compliance Plan generally addresses the requirements of the Section.**

5. Recommendations

- 22. Improve the work-request procedure for database access by requiring data-protection certifications.**

The work request should exclude an explicit certification that the requestor will not pass information outside those within the requestor's work group and having a need to use the information, will not use the information for purposes outside those that led to the approval of the request, and will retain the information in a secure location to minimize the chance that it will come into the possession of unauthorized persons.

F. Authorized Joint Products and Services

1. Statement of Applicable Requirements

Section 14:4-5.5(f) of the Standards provides that:

Subsection (e) above does not preclude an electric and/or gas public utility from offering a joint product and/or service, provided such joint product and/or service is authorized by the Board and is available to all non-affiliated product and/or service providers on the same terms and conditions, for example, joint billing services.

2. Summary of Audit Activities

The purpose of the provisions is to ensure that any joint products and or services offered by the utility are offered to non-affiliated providers on the same terms and conditions. The criterion that Liberty applied in examining performance under this standard was:

- In the event that any utility offered products or services jointly with a holding company RCBS, whether they were offered to non-affiliated providers on the same basis.

Liberty reviewed the utility's tariffs to determine whether the Company had any competitive products and services. In addition, Liberty asked whether the utility offered any competitive

services, and gathered information on the product offerings of the RCBSs who provide services at retail in New Jersey.

3. Findings

Liberty reviewed marketing plans, sales activities, advertising, and other areas of operation that would have likely disclosed any jointly offered products or services. Liberty observed the residential heat conversion efforts for the fall of 2004. Section V.M. of this report, which addresses Section 14:4-5.3(m) of the Affiliate Standards: Customer Enrollment, Marketing, and Business Development, discusses those efforts. The joint offering of heater conversion by SJG and a 12-month free SJESP service contract are the relevant aspect here. The *Community Rewards Program* discussed in section V.A. of this report also implies a linkage between SJG and SJE offerings through the claim that they jointly developed the program to provide support to non-profit operations. Liberty found no other indication of any joint marketing, promotional, and advertising programs that benefit both regulated and competitive services. The current Compliance Plan recites this provision and it notes that the rates and regulatory affairs department has responsibility for it. This department issued an October 2004 memorandum noting the Standards prohibit joint services absent prior BPU approval, which the department would have responsibility for filing.

4. Conclusions

- a. **SJG made joint product or service offerings with SJE and SJESP during the audit period; other market participants did not have the Section 14:4-5.5(f) required opportunity to participate.**

Sections V.M. and V.A. of this report describe those offerings.

- b. **The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(f).**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision, apart from those set forth in Sections V.M. and V.A. of this report.

G. Joint Purchases

1. Statement of Applicable Requirements

Section 14:4-5.5(g) of the Standards provides that:

An electric and/or gas public utility and its PUHC or related competitive business segments of its public utility holding company may make joint purchases of products and/or services, but not those associated with merchant functions.

2. Summary of Audit Activities

This provision of the standards confirms the general permissibility of joint purchases, which Liberty addresses in the ensuing section of this audit report. However, the provision also

imposes a strict prohibition against joint purchases that relate to the merchant function. Liberty applied the following criterion in examining performance under this standard:

- The utility may not make merchant-function related purchases jointly with a holding company or holding company RCBS.

Liberty requested copies of all joint purchasing agreements that included both the regulated utility and a holding company or holding company RCBS. Liberty's examination of *Gas Supply*, which companion reporting addresses, also sought detailed information about how SJG makes purchases and what transactions took place among it and affiliates during an eight-year audit period.

3. Findings

Section 14:4-5.2 of the Standards provides the following definitions relevant to Section 14:4-5.5(g):

"Joint purchases" means purchases made by a parent or holding company or affiliate thereof for use by one or more affiliates, the fully allocated costs of which are allocated to be paid proportionally by the affiliates, based upon utilization.

"Joint purchases allowed" means purchases not associated with merchant functions, examples of which would be joint purchases of office supplies and telephone services.

"Joint purchases not allowed" means purchases associated with merchant functions, examples of which would be gas and electric purchasing for resale, purchasing of gas transportation and storage capacity, purchasing of electric transmission, system operations and marketing.

"Merchant functions" means the marketing and/or the provision of electric generation service and/or gas supply service to wholesale or retail customers, as opposed to the marketing and/or provision of transmission and distribution services, by an electric and/or gas public utility.

The test work that Liberty performed as part of its examination of Gas Supply discovered no instances of joint purchases related to the merchant function.

The current Compliance Plan recites this provision, it notes that SJG does not make joint purchases associated with the merchant function, and it notes that SJG has issued a memorandum prohibiting merchant-function joint purchases. Another recent memorandum advises the officer to whom gas supply functions report of the prohibition of joint purchases associated with wholesale or retail gas supply.

4. Conclusions

- SJG complied with Section 14:4-5.5(g) of the Standards regarding joint purchases associated with merchant functions; no such purchases took place during the audit period.**

b. The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(g).

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

H. Pricing and Reporting of Joint Purchases

1. Statement of Applicable Requirements

Section 14:4-5.5(h) of the Standards provides that:

The electric and/or gas public utility must insure that all such joint purchases are priced, reported, and conducted in a manner that permits clear identification of the electric and/or gas public utility's portions and its PUHC or the related business segment's portion of such purchases, and that direct costs of the joint purchase(s) as well as the indirect purchasing costs are apportioned between the electric and/or gas public utility and the related competitive business segment of the public utility holding company in direct proportion to the relative amounts of the purchased products(s) and/or services(s) received and/or utilized, respectively, in accordance with these standards and other applicable Board allocation and reporting rules.

2. Summary of Audit Activities

The purpose of these provisions is to ensure, for all joint purchases, proper record keeping, pricing and assignment of direct and indirect costs between the utility and the RCBS. The provision's two principal requirements include the ability to segregate the utility portion of joint purchases and the allocation of both the direct and indirect costs of purchases to the utility on the basis of its portion of the purchases. Therefore, Liberty applied the following criteria in examining performance under this standard:

- Whether recordkeeping and reporting of jointly made purchases provides for accurate identification and segregation of the utility portion of purchases made through common efforts
- Whether the costs that the utility pays for purchases made through common efforts are in strict proportion to the amounts purchased for its use.

3. Findings

Liberty requested a list of all joint purchasing agreements that included both the regulated utility and an unregulated affiliate. SJG provided two:

- Master Lease Agreement with GE Capital Fleet Services
- ARI lease and fleet management services agreement

Each agreement allows any SJI entity to lease a vehicle. The only audit-period agreements for joint purchasing were these vehicle leases. SJG leased during the audit period 18 vehicles that it made available to affiliates. SJG's appliance-service business 17 of those vehicles and SJESP took over their use late in the audit period. Marina used the one remaining vehicle. SJG charged the lease costs to the ASB through August 2004, after which it began to charge SJESP for them.

SJG now charges Marina directly for that one vehicle, but had been charging it to SJI previously. SJI leased during the audit period four vehicles that subsidiaries used: two by SJESP and two by Marina. SJG personnel administer all these leases; they used time sheets to record the costs spent in this activity.

The current Compliance Plan refers to the Cost Allocation Manual for pricing and costing provisions related to joint purchases. The Rates and Regulatory Affairs Department issued an October 2004 memorandum to the head of materials management, noting the cost accounting and allocation requirements of this provision.

4. Conclusions

a. SJI and SJG directly charged the affiliate that used vehicles during the audit period.

Assigning the Marina vehicle costs to SJI adds the complicating step of assuring that costs are not reallocated back to SJG as part of the general allocator, but, given the minimal use of this approach (one vehicle) requires attention, but not a change in current practice.

b. The low level of joint purchasing, which should decrease further as SJESP picks up more of its own vehicle leasing, makes time-sheet use a reasonable means for assuring that SJI/SJG distribute fairly the costs to support such purchasing.

Time-sheet reporting captures the time of personnel can effectively capture the effort of those who directly support vehicle leasing. That is the only form of joint purchasing within the SJI family and it occurs at low and diminishing levels. The existence of a more fully integrated purchasing/materials approach, under which most affiliate purchasing comes from a central source, would require a more sophisticated approach. The benefits of developing that approach under current conditions, however, would not approach its burdens. Accordingly, the current approach serves as a reasonable proxy for identifying the support costs associated with joint purchasing.

c. The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(h).

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

I. Shared Services

1. Background

Section 14.4-5.5(1) of the Standards provides that:

An electric and/or gas public utility, its public utility holding company and related competitive business segments, or separate business segments of the public utility holding company created solely to perform corporate support services may share joint corporate oversight, governance, support systems and personnel. Any shared support shall be priced, reported and conducted in

accordance with N.J.A.C. 14:4-5.4 and this section, respectively, set forth herein, as well as other applicable Board pricing and reporting requirements.

2. Summary of Audit Activities

The provision of and charging for common services falls among the topics addressed in the reporting of Liberty's examination of *Cost Allocations and Affiliate Relationships*.

J. Protection of Confidential and Market Information

1. Statement of Applicable Requirements

Section 14:4-5.5(j) of the Standards provides that:

Such joint utilization shall not allow or provide a means for the transfer of confidential customer or market information from the electric and/or gas public utility to a related competitive business segment of its public utility holding company in violation of these standards, create the opportunity for preferential treatment or unfair competitive advantage, lead to customer confusion, or create significant opportunities for cross-subsidization of a related competitive business segment of the public utility holding company.

2. Summary of Audit Activities

This provision prohibits the utility from sharing confidential customer and market information with the holding company and related competitive business segments. The purpose of this prohibition is to prevent opportunities for cross-subsidies, customer confusion, and unfair competitive advantage. Cross-subsidies and unfair market advantages could occur in ways such as the following:

- Identification of new market opportunities
- Information concerning strategic direction of the company
- Acquiring market sensitive and related information
- Providing an opportunity for customer confusion between the identity of the utility and its PUHC or its RCBS.

The criteria that Liberty applied were as follows:

- Sufficient controls should be in place to protect competitively sensitive information regarding joint services
- The compliance plan should address handling of market sensitive information when joint services are being utilized
- Joint planning should be conducted in a manner that will protect competitively sensitive information.

This provision addresses the transfer of both customer and market information. A number of other provisions in the Standards address the protection of customer information. Liberty addresses the sufficiency of those protective efforts in connection with its discussion of those standards. Therefore, the focus of audit activities here was marketing.

The criteria that Liberty employed in examining performance under this provision were:

- Whether adequate steps are taken to prevent the transfer of protected information during planning and marketing activities
- Whether the utility compliance plan adequately addresses responsibilities imposed by this provision of the Standards.

Through the use of data requests and interviews, Liberty reviewed and analyzed the planning process at the utility and holding company as it relates to this provision of the standards. Liberty sought to determine whether competitive sensitive information was shared during the planning cycle, and what controls were in place to ensure that competitive sensitive information generated at the utility was not used by affiliates.

As its initial step, Liberty reviewed the utility's compliance plan and its procedures for complying with the Standard. Then through the use of data requests and interviews, Liberty attempted to identify opportunities in joint processes between the utility and its PUHC or RCBS where inappropriate sharing of information could occur. Liberty then reviewed and analyzed processes to ensure that adequate controls were in place to protect competitively sensitive information. To assess the controls, Liberty reviewed the information flows, the granularity of the information, who had access, and how was it used. Because of the amount of data and its competitive sensitivity, particular emphasis was placed on the planning process at the utility and the PUHC.

3. Findings

Liberty conducted the activities described under other provisions; see, for example, Sections V.C., V.M., and VII.E., to address the issues relevant to this provision as well. The findings in those sections address the criteria for this provision.

Liberty reviewed strategic and business plans of SJG. Liberty found that the business plans were separate from those of affiliated companies and Liberty could not identify any use of SJG information by affiliates in their plans. Liberty also reviewed the planning processes as part of its evaluation of Management and Operations, which is addressed in companion reporting. That examination found no indication of inappropriate commingling of information or analysis during the planning processes.

Liberty did find, however, that the structure of the marketing function at SJI provided significant and inherently difficult-to-control opportunity for utility marketing information to become accessible to affiliates. An SJI vice president who is one of six direct reports to the SJI CEO has responsibility for heading the business of SJE and for managing an SJI-level marketing and sales department. Within that SJI marketing and sales department, there is segregation of utility and non-utility personnel and activities. The vice president, however, has access to the information gleaned from the activities of both SJG and other SJI affiliates. This SJI vice president also heads a financial planning department that serves both SJG and non-utility affiliates. Section V.M. of this report provides examples of the problems that this structure can create.

The current Compliance Plan contains a certification by officers of SJI and SJI affirming that there are sufficient mechanisms in place to assure compliance with the Standards and to assure that SJG is not using corporate support services to circumvent the Standards.

4. Conclusions

a. A structural conflict in the design of SJG's marketing organization causes inherent difficulties under this provision.

The head of SJE supervises the marketing work that and SJI organization does for SJG. The incumbent, and SJI vice president, acknowledges that he has access to SJG marketing information, but emphasizes that he does not closely examine it and that it does not, in any case, have value to SJE. Several types of information at least theoretically available during the audit period to SJE through this channel cause concern; *e.g.*:

- CURA sales re-engineering work for the utility
- Screening for high-value residential heating conversion customers
- Utility-collected customer data used to evaluate the effectiveness of the heater conversion program.

Assurance that there is not an unauthorized sharing of information should not depend on personal commitments not to examine information or on certifications by an RCBS that utility information is not of value to the RCBS. Liberty emphasizes that it does not reach this conclusion on the basis of any evidence of a lack of honesty or forthrightness on the part of any person in the SJI marketing organization that has responsibilities for both SJG and RCBS work. Rather, Liberty believes that there should be structural and other controls that are consistent with the provision's requirements, independent of the character of the persons now holding the job positions involved.

b. Apart from the issue of structural conflict, the planning process does not provide an undue disadvantage or advantage to SJG vis-à-vis other affiliates.

c. The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(j).

5. Recommendations

23. Structurally separate the marketing and sales functions of SJG and its RCBSs.

SJG's marketing work should be performed by resources dedicated to utility work and reporting through a separate chain of responsibility from those who perform work for RCBSs. No SJI manager or executive (beneath the level of CEO) who has material responsibility in connection with the operations of an RCBS should form part of the reporting chain of the personnel who perform utility marketing and sales activities. In particular, the reporting of personnel who perform marketing and sales work for SJG should not be through the head of SJE.

In the past, any duplication of positions occasioned by this recommendation may have imposed significant economic burdens on SJI's then-smaller non-utility businesses. The combination, however, of their growth in recent years, their expected continued growth, and the inability to

date to bring marketing and sales interactions into full compliance with the Standards makes this change appropriate and important for assuring that affiliation with SJG does not create any material barrier to competition.

K. Use of Utility Name and Logo

1. Statement of Applicable Requirements

Section 14.4-5.5(k) of the Standards provides that:

A related competitive business segment of a public utility holding company shall not trade upon, promote, or advertise its relationship with the electric and/or gas public utility, nor use the electric and/or gas public utility's name and/or logo in any circulated material, including, but not limited to, hard copy, correspondence, business cards, faxes, electronic mail, electronic or hardcopy advertising or marketing materials, unless it discloses clearly and conspicuously or in audible language that:

- 1. The PUHC or related competitive business segment of the public utility holding company "is not the same company as [LDC's NAME HERE], the electric and/or gas public utility";*
- 2. The PUHC or related competitive business segment of the public utility holding company is not regulated by the Board; and*
- 3. "You do not have to buy [RELATED COMPETITIVE BUSINESS SEGMENT'S NAME HERE] products in order to continue to receive quality regulated services from the electric and/or gas public utility."*

2. Summary of Audit Activities

These provisions address how a holding company RCBS may promote itself, particularly if it shares a similar name or logo with the regulated utility. A holding company RCBS may not use its connection with the utility to promote itself, nor may it use the utility's name or logo in any form of communication, unless it clearly and conspicuously provides the required disclaimer. The disclaimer is required only with regard to the use of the utility's name or logo in New Jersey.

Liberty requested information concerning the use of logos, trademarks and service marks, in order to determine whether there was any shared use of the utility name or logo, and, if so, whether the required disclaimer was prominently displayed. Liberty requested copies of utility and affiliate logos, trademarks and service marks and details of where the marks were used.

Liberty also reviewed the websites and utility compliance plan for adherence to these standards.

3. Findings

SJI undertook a 1999 study that eventually led to the introduction of a new set of marks in 2000. The goal of this study was to "Develop a symbol when combined with either SJI, or SJG, or SJE will transfer the equity from one to the other." Linkage with the past and transfer of brand equity among businesses comprised two specific considerations applied in designing the new

marks. One factor in adopting the pictorial element of the new mark was that, "Its inspiration is the SJG orb," which provided the desired link to the past, while providing a more contemporary image. It was viewed as providing a symbolic representation of three elements: SJI, SJG, and SJE.

The current Compliance Plan recites this provision, and notes that a review process has been established to examine instances where it applies. The Rates and Regulatory Affairs Department asked the SJG Corporate Communications Department to provide in October 2004 a certification that it was in compliance with this provision. This certification was provided.

SJE brochures used during the audit period used the pictorial portion common to all SJI logos, and identified SJE as the particular affiliate sponsoring the material. SJE sometimes, but not always, included in its brochures the disclaimer language separating itself from SJG, and advising that it was not necessary for a customer to buy from SJE in order to receive quality service from SJG. In one flyer that did not contain the disclaimer language, SJE promoted a savings of 4 cents per therm by switching to SJE. This brochure contained the following statement:

When "New Jersey Energy Choice" was created by legislation in 1999, the energy industry was deregulated. South Jersey Industries, parent company of South Jersey Gas, created its deregulated energy marketing affiliate, South Jersey Energy.

SJG and SJE used during the audit period a joint brochure promoting both appliance-service contracts and a switch from SJG to SJE for gas supply. The brochure contains many references to both these affiliates, and generally creates the image of connection between SJG, appliance services, and SJE. In relatively small print at the bottom of the left page of the brochure is the disclaimer language.

Letterhead, business cards, and other similar standard stock use the common logo, with distinct names for each particular entity. They do not as a matter of course use the disclaimer.

SJI makes more significant use of logo commonality than do other holding companies whose utilities serve New Jersey. Among those who provide retail energy or appliance services in New Jersey, SJI is, moreover, unique in failing to use the disclaimer on the website of its affiliates who perform such services; *i.e.*, SJE and SJESP. Those holding companies that have affiliates listed on web sites as providing these services do the following:

- First Energy uses a much more modest pictorial connection, its retail energy affiliate does not share name elements with the utility, and the web-site of that affiliate prominently features the disclaimer.
- New Jersey Resources uses the same pictorial element for its parent, gas utility, and services businesses, but the logo for the entity providing retail appliance installation and maintenance (*NJR Home Resources*) has no direct connection with the gas utility name; the web site of its services business contains the disclaimer.
- Conectiv does not share a common logo (pictorially or otherwise) with its parent or the holding company RCBS that provides competitive energy services in parts of the states where the parent's utility operating companies provide utility services; the web page of

that entity providing retail services, Pepco Energy Services, has no connection with the utility name, and contains a disclaimer of connection with the utility.

ETG and its parent share a common pictorial element, but their web sites do not list retail affiliates. PSEG uses a common pictorial element and the PSEG name in all its logos, but lists no retail affiliates. The utility, PSE&G, provides appliance service, but the rules about logo use differ for utility and holding company RCBSs. Orange & Rockland and its parent, ConEd share the pictorial element of their logos and the Orange & Rockland logo notes its affiliation with ConEd, but there are no retail affiliates listed on either site. The parent's site links to that of its retail energy and telecommunications affiliates, which share logo and name elements with the parent and with the New York utility, and which do not operate in New Jersey. Their sites do not contain a disclaimer.

4. Conclusions

- a. SJI has specifically sought to transfer the goodwill associated with its utility operations through the design and use of marks that have virtually identical pictorial elements and similar name elements.**

The intention shown as part of the process of developing the current marks is clearly one of extending the goodwill established through historical operations, which SJG dominated. It has often been that case that holding companies formed on top of long-standing utility companies have created new marks, technically made them the property the holding company, and made them available to the utility. That technicality can raise hypothetical questions about whether the marks are actually the utility's marks. Even if that is the case here, however, the process of creating the new marks makes clear the intent and effect of affiliate trading upon relationship with the utility. Moreover, the documents that Liberty reviewed showed that the new marks drew inspiration from and were formed to create a link to SJG marks.

- b. SJG and the RCBSs of SJI make significantly more extensive use of common logos and marks than do the other holding companies with New Jersey utilities.**

In part, but not entirely, this phenomenon may result from the fact that mergers and acquisitions involving some of those other companies have caused them to start with multiple recognizable names and marks. Regardless of the causes, however, SJI has clearly made significantly more use of its utility name and reputation than is the case for the New Jersey utility community. SJI also has, when compared with this peer group, more extensive (given its size) RCBS operations in areas closely related to its utility business.

- c. The web sites of SJE, SJESP, and Marina make use of the common logos and marks, some promote the connection between them and SJG, and all fail to provide the required disclaimer.**

SJI is unique among utility-affiliated providers of retail energy and appliance installation and maintenance services in failing to use the disclaimer on the pages of its retail affiliates. Moreover, the SJE web site creates a number of connections between SJG and itself.

- d. The RCBSs do not always use the disclaimer in marketing and sales materials, and those provided are sometimes not conspicuous.**

Liberty's examination of marketing and sales materials disclosed inconsistent practice in including the disclaimers.

What constitutes a *conspicuous* disclaimer is clearly judgmental. However, Liberty's examination of marketing materials showed that it was occasionally difficult to spot the disclaimer readily, even though the reviewer was specifically looking for it. The provision is intended for the benefit of readers not looking for disclaimers.

- e. SJI has, like the electric utilities that Liberty audited in the last EDECA cycle, failed to tackle the difficult issue of business cards and letterhead.**

This provision of the Standards requires use of the disclaimer on business cards and letterhead. Like the RCBSs of the holding companies of the electric utilities that Liberty examined in the last EDECA audit cycle, SJI affiliates do not use the disclaimers on such standard *stock* materials.

- f. The Compliance Plan otherwise adequately addresses Section 14.4-5.5(k) of the Standards.**

5. Recommendations

- 24. Mandate that disclaimer required under Section 14.4-5.5(k) of the Standards be made on all materials circulated in New Jersey from any RCBS and related to marketing or sales.**

A source other than the RCBS making the circulation should certify that the disclaimer meets the conspicuity element of the provision. The compliance director whose establishment Liberty recommended in Chapter III is a logical choice to fill this role.

- 25. Make the disclaimer required under Section 14.4-5.5(k) of the Standards on the opening page of the website of each RCBS, and on any other page mentioning SJG or the provision of utility service offerings in New Jersey.**

- 26. Prepare and submit to the Board a report describing the stock materials where RCBSs use the disclaimer required under Section 14.4-5.5(k) of the Standards, and, when it is not used, its reasoning as to why it is omitted.**

As Liberty intended in the last round of electric utility EDECA audits, there should be a reasonably uniform state policy regarding the use of the disclaimer on stock materials. The nature, size, and use of many of them may make rote use of the disclaimer impractical.

L. Non-New Jersey Use of Utility Name and Logo

Section 14.4-5.5(l) of the Standards provides that:

The requirement of the name and/or logo disclaimer set forth in (k) above is limited to the use of the name and/or logo in New Jersey.

This section of the standards does not provide a conduct standard that is auditable. It merely narrows the restrictions imposed by Standard Section 14:4-5.5(k).

M. Promising or Implying Preferred Treatment

1. Statement of Applicable Requirements

Section 14:4-5.5(m) of the Standards provides that:

An electric and/or gas public utility, through actions or words, shall not represent that, as a result of its PUHC or a related competitive business segment of the public utility holding company's relationship with the electric and/or gas public utility, its affiliate(s) will receive any different treatment than other product and/or service providers.

2. Summary of Audit Activities

The requirements of this section are similar to those of Sections 14:4-5.3(a) and (c). Liberty's audit activities were the same as those set forth for Sections 14:4-5.3(a) and (c).

3. Findings

Liberty's findings are the same as those set forth for Sections 14:4-5.3(a) and (c).

4. Conclusions

Liberty's conclusions are the same as those set forth for Sections 14:4-5.3(a) and (c).

5. Recommendations

Liberty's recommendations are the same as those set forth for Sections 14:4-5.3(a) and (c).

N. Use of Utility Advertising Space

1. Statement of Applicable Requirements

Section 14:4-5.5(n) of the Standards provides that:

An electric and/or gas public utility shall not offer or provide to its PUHC or a related competitive business segment of its public utility holding company advertising space in the electric and/or gas public utility's billing envelope(s) or any other form of electric and/or gas public utility's written communication to its customers unless it provides access to all other unaffiliated services providers on the same terms and conditions.

2. Summary of Audit Activities

These provisions prohibit joint marketing activities between the utility and an RCBS of its holding company. The utility may not promote the holding company RCBS in its billing

envelope or in other written communication unless competitors are offered the same opportunity. Liberty applied the following criterion in examining performance under this standard:

- If space is provided to an RCBS in any written communications to utility customers, it must be similarly provided to others.

Liberty requested information about all joint marketing activities pertaining to compliance with these provisions of the Standards. Liberty also requested a copy of all utility bill inserts. Liberty has also reviewed the utility compliance plan with regard to this section of the Standards.

3. Findings

SJG has undertaken only one documentary joint marketing, promotional, or advertising program benefiting both regulated and competitive services. Utility bill inserts did not promote the holding company or its RCBSs during the audit period. After SJESP acquired the appliance-service business from SJG, bill inserts for appliance services ceased. The current Compliance Plan recites this provision, and notes that billing-insert issues fall within the responsibility of the customer care center. The SJG rates and regulatory affairs department advised the *Customer Care Center* manager in October 2004 that SJG policy prohibited access by all affiliates and non-affiliates to customer bills. The manager provided a certification of compliance with this policy.

4. Conclusions

- a. **SJG did not provide advertising space for its PUHC or PUHC RCBSs in utility billing inserts during the audit period.**
- b. **SJG did not provide an affiliate with advertising space in any written customer communications to its PUHC or PUHC RCBSs during the audit period.**
- c. **The Compliance Plan adequately addresses the requirements of Section 14:4-5.5(n).**

5. Recommendations

Liberty has no recommendations regarding this requirement of the standards.

O. Joint Advertising or Marketing

1. Statement of Applicable Requirements

Section 14:4-5.5(o) of the Standards provides that:

An electric and/or gas public utility shall not participate in joint advertising or joint marketing activities with its PUHC or related competitive business segment of its public utility holding company which activities include, but are not limited to, joint sales calls, through joint call centers or otherwise, or joint proposals (including responses to requests for proposals) to existing or potential customers.

1. The prohibition in (o) above notwithstanding, at a customer's unsolicited request, an electric and/or gas public utility may participate, on a

nondiscriminatory basis, in non-sales meetings with its PUHC or a related competitive business segment of its public utility holding company or any other market participant to discuss technical or operational subjects regarding the electric and/or gas public utility's provision of distribution service to the customer;

2. Except as otherwise provided for by these standards, an electric and/or gas public utility shall not participate in any joint business activity(ies) with its PUHC or a related competitive business segment of its public utility holding company which includes, but is not limited to, advertising, sales, marketing, communications and correspondence with any existing or potential customer;

3. An electric and/or gas public utility shall not participate jointly with its PUHC or a related competitive business segment of the PUHC in trade shows, conferences, or other information or marketing events held in New Jersey; and

4. An electric and/or gas public utility shall not subsidize costs, fees, or payments with its PUHC or related competitive business segments of its public utility holding company associated with research and development activities or investment in advanced technology research.

2. Summary of Audit Activities

These provisions prohibit joint marketing activities or the joint funding or support of research and development activities between the utility and an RCBS of its PUHC. Joint advertising or marketing activities between the utility and the PUHC RCBS are prohibited, including (but not limited to):

- Joint sales calls
- Joint call centers
- Joint proposals or responses to RFPs
- Joint advertising, marketing, communications, or correspondence
- Joint participation in trade shows, conferences, or other information or marketing events held in New Jersey
- Joint business activities

The utility may at the customer's unsolicited request participate in non-sales meetings with its PUHC RCBS in order to discuss technical or operational subjects regarding the provision of distribution services, provided the same participation is offered on a nondiscriminatory basis to competitors. Subsidization by the utility of R&D costs, fees, or payments with the PUHC RCBS is prohibited.

Liberty applied the following criteria in examining performance under this standard:

- Except in the case of unsolicited customer requests, the utility should not engage in any of the proscribed joint marketing and sales activities
- The utility should not participate with its holding company or a holding company RCBS in joint funding of research and development activities in a manner that fails to assign a proper share of the costs to the holding company or holding company RCBS.

Liberty requested information on all joint marketing, promotional, and advertising programs that benefited both regulated and competitive services. Liberty also asked about sharing of space at trade shows. Liberty also requested information on practices and policies for utility participation in non-sales meetings with affiliates or non-affiliates. Liberty has also reviewed the utility compliance plan for its procedures regarding this section of the Standards.

Liberty also interviewed utility personnel and requested information on the amount of research and development and advanced technology expenditures by the utility and the PUHC or a PUHC RCBS.

3. Findings

SJI reported that there was no joint marketing or advertising during the audit period. The Company reported that it designed each program specifically for a single business line, and that the business line involved paid for the costs of the programs developed and implemented for them. Liberty reviewed the audit-period marketing plans of each SJG affiliate. None existed prior to 2003. SJE and SJESP had marketing plans for 2003 and 2004. Marina had a marketing plan for 2004. A review of these plans disclosed no joint marketing plans or programs. Each affiliate established its own marketing goals and activities, and equipped itself to carry them out with its own or with separately contracted resource. The plans, however, did identify a number of areas of commonality with SJG:

- The 2003 SJE marketing plan noted the use of Millennium personnel to place advertisements on the doors of customers as they read meters (with an estimate that 5 percent of projected residential customer growth and no commercial customer growth would come from this use).
- The 2003 SJE plan also noted an employee lead program using SJG appliance service technicians (with an estimate that 5 percent of projected residential customer growth and no commercial customer growth would come from this use).
- The 2004 SJE marketing plan noted continued use of Millennium and the employee-lead programs.
- SJE's 2003 plan also began with the statement that it would "trade off" the positive SJI/SJG brand, citing the slogan common to all SJI affiliates; *i.e.*, "Where we put all of our Energy".
- The SEJESP (known as South Jersey Gas Service Plus at the time) 2003 marketing plan noted that would retain through general awareness newspaper and radio advertising the "brand equity of the business with the same logo and tagline of South Jersey Gas"
- SJESP's 2004 marketing plan included a similar component .

The affiliate marketing plans gave no indication of reliance upon research or analysis performed for SJG. The SJE plan, in fact, noted that one of the firm's weaknesses was lack of access to a comprehensive database for making contacts in its market. The SJESP marketing plan for 2003 anticipated the transfer of the business to a separate subsidiary. It noted that such a transfer would cause the loss of the opportunity for using utility bill inserts, which had constituted the primary sales channel for the business while operated from within the utility. All of the cited replacement vehicles for reaching customers appeared typical of similar businesses and none depended upon association with the utility or use of its resources.

There was joint participation in trade shows by SJG and non-utility affiliates. Each used its own booth and was responsible for staffing, designing, and paying the costs of displays. SJI companies ask for affiliate booths to be kept apart. There were no audit-period occasions on which SJG and affiliate booths were continuous or directly across from each other. The following table summarizes the audit-period trade shows.

Table VII-5.
SJG and SJE Trade Show Attendance

Period	SJG	SJE	Common
Oct-Dec 2002	5	5	4
2003	17	14	10
Jan-Sep 2004	14	16	9

SJI did report one exception, which is an annual company golf/barbeque outing. SJG bears the entire cost of this outing, but invitations go out to large commercial and industrial customers of SJG and affiliates. The following table summarizes the invitees and costs for these outings during the audit period. The Company does not segregate customers invited by the SJI entity that serves them.

Table VII-6. SJG Golf Outing Costs

	2002	2003	2004
<i>Costs</i>	\$	\$	\$
<i>Invitees</i>			
SJI Employees	17	16	16
SJG Employees	23	21	24
SJE Employees	7	5	6
Customers	298	346	429

The SJG bill inserts during the audit period made no mention of SJE, nor did they include any information that would tend indirectly to support SJE marketing or sales efforts. There were, however, a number of inserts for appliance services.

The current Compliance Plan recites this provision, and notes that billing-insert issues fall within the responsibility of the marketing department. The SJI CFO issued an October 2004 memorandum reminding key personnel of the need to take steps to assure continued compliance with this provision, with respect to SJI, SJE, and SJESP.

SJI participated in many civic, charitable, and business community events during the audit period. Spending \$100,000 or more annually in the past two years on sponsorship and attendance fees. The listing of events and their sponsors suggest widespread attendance and sponsorship by large groups in which SJI would, at most, have represented a small participatory interest. Moreover, the accounting for costs for sponsorship and attendance lists only insignificant attendance by RCBS employees at events in which SJG or even SJI played a sponsorship role.

SJG and SJE used during the audit period a joint brochure promoting both appliance-service contracts and a switch from SJG to SJE for gas supply. Section VII.K. of this report, *Use of Utility Name and Logo* describes that brochure.

Liberty asked for a listing of R&D expenditures during the audit period; SJG replied that there were none.

4. Conclusions

a. SJI/SJG took particular care in assuring separation of company booths at the many trade fairs, conventions, and marketing events in New Jersey.

b. SJG did not allow RCBS information to be inserted into bills.

SJG did allow ABS inserts while it operated that business, but eliminated them when it transferred the business to SJESP as of September 2004.

c. The joint SJG ASB and SJE advertising and the SJI golf outing constituted joint advertising or marketing covered by this provision.

In addition to comprising the kind of activity that this provision restricts, the golf outing was entirely funded by SJG, despite the benefits it produced for the RCBSs whose customers attended. The transfer of the appliance-service business to SJESP has dramatically reduced the potential for further violations of joint marketing restrictions. Liberty believes that the recommendations it has made elsewhere in this report sufficiently address any ongoing concerns arising from that potential.

d. The Compliance Plan adequately addresses this provision.

e. SJG did not fund or support any R&D or advance technology efforts that benefited an RCBS.

5. Recommendations

27. End the use of SJI entity outings or similar entertainment or charitable events that include customers of both SJG and RCBSs.

P. Joint Employees

1. Statement of Applicable Requirements

Section 14:4-5.5(p) of the Standards provides that:

Except as permitted in (i) and (j) above, an electric and/or gas public utility and its PUHC or related competitive business segments of its public utility holding company which are engaged in offering merchant functions and/or electric related services or gas related services shall not employ the same employees or otherwise retain, with or without compensation, as employees, independent contractors, consultants, or otherwise.

1. Other than shared administration and overheads, employees of the competitive services business unit of the public utility holding company shall not also be involved in the provision of non-competitive utility and safety services, and the competitive services are provided utilizing separate assets than those utilized to provide non-competitive utility and safety services.

2. Summary of Audit Activities

The criteria that Liberty employed in examining performance under this provision were:

- Whether any employee of a holding company RCBS was provided to the utility as an employee, consultant, or independent contractor for the performance of non-competitive utility and safety services.
- Whether there was any sharing of employees or assets between the utility and a holding company RCBS engaged in the merchant function.

Liberty requested and analyzed information from the utility identifying which, if any, employees of affiliates (other than a service company and the holding company) provide non-competitive utility and safety services.

3. Findings

Liberty asked about employee and asset sharing between SJG and affiliates during the audit period. SJG told Liberty that there were none. Liberty's examination of affiliate transactions and organization structure and staffing revealed none. Millennium is a holding company RCBSs under the Standards. Millennium's employees provided non-competitive utility and safety (meter-reading) services, through their role as employees of the contractor who provided infrastructure services to the utility. One SJG employee was seconded to Millennium during the audit period. There were no other occasions of employee seconding to affiliates during the audit period.

The current Compliance Plan recites this provision, and notes that shared employees and officers have been eliminated. The SJI CFO issued an October 2004 memorandum reminding key managers about this provision.

No SJG employee during the audit period simultaneously served any affiliate simultaneously as an employee, contractor, consultant, or otherwise, apart from those offering shared services subject to billing or allocation to such an affiliate. No affiliate employees during the audit period were simultaneously engaged in the provision of utility and safety services, apart from shared administration and overheads.

4. Conclusions

- a. Apart from Millennium, whose status has been addressed by the Board, there was no sharing of employees or assets covered by this provision of the Standards.**
- b. The Compliance Plan adequately addresses Section 14:4-5.5(p) of the Standards.**

5. Recommendations

Liberty has no recommendations regarding this requirement of the standards.

Q. Common Directors and Officers

1. Statement of Applicable Requirements

Section 14:4-5.5(q) of the Standards provides that:

An electric and/or gas public utility and the PUHC or related competitive business segments of its public utility holding company shall not have the same persons serving on the Board of Directors as corporate officers, except for the following circumstances:

- 1. In instances when these standards are applicable to public utility holding companies, any board member or corporate officer may serve on the holding company and with either the electric and/or gas public utility or a related competitive business segment of the public utility holding company, but not both the electric and/or gas public utility holding company and a related competitive business segment of the public utility holding company.*
- 2. Where the electric and/or gas public utility is a multi-state utility, is not a member of a holding company structure, and assumes the corporate governance functions for the related competitive business segments, the prohibition against any board member or corporate officer of the electric and/or gas public utility also serving as a board member or corporate officer of a related competitive business segment shall only apply to related competitive business segments operating within New Jersey.*
 - i. In the case of shared directors and officers, a corporate officer from the electric and/or gas public utility and holding company shall verify, subject to Board approval, in the electric and/or gas public utility's compliance plan required pursuant to N.J.A.C. 14:4-5.7(a) through (e), the adequacy of the specific mechanisms and procedures in place to ensure that the electric and/or gas public utility is not utilizing shared officers and directors in violation of the Act or these standards.*

2. Summary of Audit Activities

Liberty requested a list of Directors and Officers for each company in addition to asking for any information on any position changes that were made during the audit period.

3. Findings

The following table shows the holding company's officers during the audit period. The names followed by an asterisk are those who served also as SJG officers during the of the audit period.

Table VII-7. SJI Officers

Position	Start Date	End Date
<i>President and CEO</i>		Apr-04
Biseglia*		
<i>Executive VP and COO</i>		
Graham*		
<i>VP and CFO</i>		
Kindlick*		
<i>Corp Secretary and Counsel</i>		
Walker*		
<i>became VP as well in Feb 2004</i>		
<i>Vice Presidents</i>		
Ruggiero*		
DuBois*	Feb-04	
Jackson*	Feb-04	
Renna	Feb-04	
<i>Treasurer</i>		
Clark*	Feb-04	
<i>Assistants</i>		
Renna		Feb-04
Kelly		
Bisceglia became CEO only in Jan 2003		
Graham became President/COO in Jan 2003		
Graham became President/COO in April 2004		
Renna was an Asst VP until February 2004		

Mr. Graham became an officer of SJG in January of 2003. At that time, he resigned his officer positions with SJE. He remained an officer of the following affiliates:

- President of SJR
- Vice President of SJES (South Jersey Energy Solutions, LLC; listed as inactive by October 1, 2004)
- President of Marina

Mr. Walker served during the audit period as an officer of the following affiliates:

- President and Secretary of Energy & Minerals, Inc.
- President and Secretary of R&T Group, Inc.
- President and Secretary of South Jersey Fuel Company
- Secretary of SJ EnerTrade, Inc.
- Executive Committee Member of Millennium (resigned from this position on October 1, 2004)
- Secretary and General Counsel of SJR
- Secretary of SJES
- Secretary of AirLogics
- Secretary and General Counsel of Marina

Mr. Ruggiero served during the audit period as an officer of the following affiliates:

- Executive Committee Member of Millennium(resigned from this position on October 1, 2004)

Mr. DuBois served during the audit period as an officer of the following affiliates:

- Vice President of SJR

No other SJG officers served simultaneously as officers of other affiliates during the audit period.

SJI has structured its board memberships so that all members of the parent board serve on either but not both of the boards of SJG and of the non-utility subsidiaries. During the audit period, Mr. Bisciegia and Mr. Graham served on the utility boards and on the boards of the following subsidiaries:

- Marina
- SJR
- SJESP (until October 1, 2004)
- Energy & Minerals, Inc.
- R&T Group, Inc.

The current Compliance Plan recites this provision. It also contains the required affirmation regarding shared officers and directors. The SJI CFO issued an October 2004 memorandum to officers and internal directors briefly summarizing the requirements of this provision.

Mr. Renna serves as the President of SJE and as a Vice President of SJI. In the latter capacity, a number of the marketing personnel who work on SJG matters report to him. Mr. DuBois is an officer of both SJI and of SJG. He was, but is no longer an officer of SJRG. The person who replaced him as an SJRG officer reports to Mr. DuBois, however.

4. Conclusions

a. Outside director separation meets the requirements of this provision.

b. Inside director separation generally meets the requirements of this provision, but Marina is an exception.

The Marina exception clearly exists because SJI does not consider Marina to be an RCBS.

c. While facially compliant with the requirements, the SJI officer structure is problematic in two respects.

Technically, SJI ended a case of non-compliance with this provision by replacing an SJRG officer. The incumbent retained his SJG role, took on an executive position with the holding company, and relinquished his SJRG position. However, his replacement in the SJRG role reports to him. In effect, therefore, he still has executive responsibility for SJRG. Section VII.J. of this report discusses the structural conflict that exists because the President of SJE has responsibility for the SJI organization that performs marketing work for SJG. A recommendation in that section addresses that conflict sufficiently.

d. The Compliance Plan adequately addresses Section 14:4-5.5(q) of the Standards.

4. Recommendations

28. Eliminate the reporting of the SJRG vice president to the person he replaced.

R. Employee Transfers

1. Statement of Applicable Requirements

Section 14:4-5.5(r) of the Standards provides that:

All employee transfers between an electric and/or gas public utility and its PUHC or related competitive business segments of its public utility holding company providing or offering competitive services to retail customers in New Jersey which are engaged in offering merchant functions and/or electric related services or gas related services shall be consistent with following provisions:

- 1. The electric and/or gas public utility shall make a public posting of all employee transfers within three working days.*
- 2. An electric and/or gas public utility shall track and report annually to the Board all employee transfers between the electric and/or gas public utility and such related competitive business segments of its public utility holding company.*
- 3. Once an employee of an electric and/or gas public utility is transferred to such related competitive business segment of its public utility holding company, said employee may not return to the electric and/or gas public utility for a period of one year, unless the related competitive business segment of the public utility holding company to which the employee is transferred goes out of business or is acquired by a non-affiliated company during the one-year period.*
- 4. In the event that an employee is returned to the electric and/or gas public utility, such employee cannot be transferred for employment by a related competitive business segment of the public utility holding company which is engaged in offering merchant functions and/or electric-related services or gas-related services for a period of one year.*

2. Summary of Audit Activities

This provision limits the competitive impact on unaffiliated suppliers of public utility employee movement from or to the PUHC or a related competitive business segment. To the extent that transfers occur, the provision makes them transparent to regulators and competitors. These limitations prevent PUHCs and related competitive business segments from gaining competitive advantage through inappropriate transferring of employees to or from the public utility. Advantages could be gained in the following manners:

- Frequent transfer of employees with special expertise or knowledge
- Joint use of employees with special expertise or knowledge
- Transferring employees utilizing knowledge or transporting information gained at the utility for the benefit of the PUHC or related competitive business sector or vice versa.

Liberty sought to determine if employee transfers from SJG to a holding company or holding company RCBS occurred during the audit period. Liberty then ascertained whether SJG publicly posted the information within the three working day period. Liberty then proceeded to determine if any transferring employee was provided proper instructions on the employee's use of retained information Liberty also determined if SJG made any required annual filing of employee transfer information with the Board.

In addition, Liberty determined whether any employee that did transfer from SJG to the holding company or holding company RCBS and vice-versa met the one-year requirement on transferring back to the previously held job at the affected entity. As a part of this evaluation Liberty determined whether any such employees were properly instructed on confidential, competitively-restricted information prior to and after the transfer.

3. Findings

Total full-time employment totals for SJI did not change substantially during the audit period. SJG has had a small number of part-time employees across this period – falling from nine to three. The following table shows the numbers of employees by affiliate.

Table VII-8. Full-Time Employees by Affiliate

	Sep-02	Dec-02	Mar-03	Jun-03	Sep-03	Dec-03	Mar-04	Jun-04	Sep-04
SJI									
Mgt	24	23	23	28	32	34	37	40	35
Non-Mgt	2	2	2	2	7	16	16	16	2
<i>Total SJI</i>	<i>26</i>	<i>25</i>	<i>25</i>	<i>30</i>	<i>39</i>	<i>50</i>	<i>53</i>	<i>56</i>	<i>37</i>
SJG									
Mgt	182	184	182	177	174	175	170	171	170
Non-Mgt	413	408	397	401	396	399	395	389	342
<i>Total SJG</i>	<i>595</i>	<i>592</i>	<i>579</i>	<i>578</i>	<i>570</i>	<i>574</i>	<i>565</i>	<i>560</i>	<i>512</i>
SJESP									
Mgt.									11
Non-Mgt.									61
<i>Total SJESP</i>									<i>72</i>
SJE									
Mgt	6	6	7	8	7	7	8	7	8
Non-Mgt	4	3	3	2	3	3	4	4	3
<i>Total SJE</i>	<i>10</i>	<i>9</i>	<i>10</i>	<i>10</i>	<i>10</i>	<i>10</i>	<i>12</i>	<i>11</i>	<i>11</i>
SJR									
Mgt	5	5	5	5	5	5	5	5	5
Grand Total	636	631	619	623	624	639	635	632	637

SJG reported employee transfers made in 2002 to the BPU in on January 14, 2003. There were two transfers in 2002, but neither occurred during the audit period. SJG also filed on October 19, 2004 a report of transfers during 2003. It listed four transfers. There were 12 transfers in 2003. Ten of these transfers reflected the elevation of certain functions from SJG to the holding company level. The following table summarizes the year 2003 transfers.

Table VII-9. 2003 Employee Transfers

Former Position	New Position	Date
SJG Dir. Appliance Service/Warranty Programs	SJI Dir. Appliance Service/Warranty Programs	June 1
SJG Manager Governmental Relations	SJI Manager Governmental Relations	June 1
SJG Government Relations Specialist	SJI Government Relations Specialist	June 1
SJG Director Financial Planning	SJI General Manager Financial Planning	June 1
SJG Senior Budget Analyst	SJI Senior Budget Analyst	June 1
SJG Operations Analyst	SJI Operations Analyst	June 1
SJG Budget Analyst, Marketing/Rates	SJI Budget Analyst, Marketing/Rates	June 1
SJG Manager Internal Audit	SJI Manager Internal Audit	December 21
SJG Budget Senior Internal Auditor	SJI Budget Senior Internal Auditor	December 21
SJG Secretary A	SJE Billing System Administrator	February 23
SJG-ASB Sr. Supervisor	SJI Installation Manager	June 1
SJE Retail Clerk	SJG Customer Care Representative	June 29

As part of the removal of the Appliance Service Business from SJG to a new SJI subsidiary, SJESP, the Company made a number of employee transfers. A Stipulation approved by the BPU in connection with that removal (which the BPU approved in Docket No. GM02080609) required that SJG provide a list of all SJG employees transferred to SJESP. SJG provided that list under cover of a September 1, 2004 letter. The list included 48 employees, categorized as the following table shows. There was one other transfer in 2004; the SJG sales system technical coordinator became an electric energy analyst for SJE.

Table VII-10. SJG to SJESP Employee Transfers

Appliance Service Technician	31
Parts & Appliance Service Supervisor	1
Appliance/Utility Service Supervisor	3
AST Inspector	4
Order Entry/Parts Clerk	2
Appliance Dispatch/Service Representative	5
General Manager Appliance Service Operations	1
Customer Care & Dispatch Supervisor	1

SJG has separate, formal policies for posting notice of vacant positions for bargaining unit and non-bargaining unit positions. Each lists the factors to be considered in evaluating candidates. Compliance with the provisions of the Standards is not listed as a criterion. The bargaining unit policy refers specifically to SJG. The non-bargaining unit policy has a broader scope. It refers to SJI and all of its subsidiaries and it suggests that bidding for openings in other affiliates is promoted. The policies do not require notification to candidates about the applicability of the Standards.

The current Compliance Plan recites this provision, and notes that the human resources department has responsibility for such transfers. The corporate counsel issued an October 2004 memorandum summarizing for SJG officers and key managers the requirements of this provision.

The SJI web site included posts of audit-period transfers, but there was no evident way for anyone to find them without knowing a specific sub-address.

4. Conclusions

- a. SJG made required reports about employee transfers during the audit period, but not routinely on a timely basis.**

SJG filed with the BPU the required annual reports for 2001 and 2002 in January of the following year, but delayed the filing of the 2003 report until October 2004. SJG made the required filing of transfers associated with the creation of a separate, non-utility subsidiary to conduct its appliance service business.

- b. There was posting of employee transfers as required by Section 14:4-5.5(r) of the Standards, but not in an accessible manner.**

- c. No employee retransferred back to a former position within a year of the initial transfer during the audit period.**

There was no transfer back to an original position within 12 months, but a clerk/customer care representative who transferred from SJG to SJE on May 5, 2002, did transfer back to the same utility position about 14 months later; *i.e.*, on June 29, 2003.

- d. The SJI position-posting process does not address the transfer provisions of the Standards.**

It does not include any notice of the need for preserving the confidentiality of utility information.

- e. The Compliance Plan adequately addresses Section 14:4-5.5(r) of the Standards.**

5. Recommendations

- 29. Assure timelier reporting of employee transfers to the BPU, and provide a link that enables the location of transfer postings.**

This function should be the responsibility of the compliance director whose appointment Liberty recommended in Chapter III of this report.

- 30. Include in job postings, where applicable, a notice of the need for preservation of the confidentiality of protected information.**

S. Use of Utility Information after Employment Transfers

1. Statement of Applicable Requirements

Section 14:4-5.5(s) of the Standards provides that:

Employees transferring from an electric and/or gas public utility to a related competitive business segment of the public utility holding company are expressly prohibited from using any information gained from the electric and/or gas public utility to the benefit of the related competitive business segment of the public utility holding company or to the detriment of other unaffiliated product and/or service providers.

- 1. Any electric and/or gas public utility employee hired by a related competitive business segment of the public utility holding company shall not remove or otherwise provide information to said affiliate which said related competitive business segment of the public utility holding company would otherwise be precluded from having pursuant to these standards.*
- 2. An electric and/or gas public utility shall not make temporary or intermittent assignments, or rotations to related competitive business segments of its public utility holding company.*

2. Summary of Audit Activities

The first provision prohibits inappropriate use of utility information by transferred employees. The second prohibits rotations that would have the effect of making such information available without permanent transfer.

As a threshold matter, Liberty first sought to determine if employee transfers from the utility occurred during the audit period. Liberty reviewed utility employment practices, and analyzed severance or exit procedures used when an employee transfers to an affiliated company. Liberty also inquired whether any public utility employees were provided temporary or intermittent jobs with the holding company or holding company RCBS. Liberty also reviewed the utility compliance plan and conducted interviews concerning temporary assignments, transfers, and rotations with human resources personnel.

3. Findings

SJG reports that there were no short-term, temporary assignments of personnel between affiliates during the audit period.

The current Compliance Plan recites this provision, and notes that the human resources department has responsibility for such transfers. The corporate counsel issued an October 2004 memorandum summarizing for SJG officers and key managers the requirements of this provision.

4. Conclusions

- a. There were audit-period transfers that this provision restricts.**
- b. SJG has reasonable controls in place to prevent prohibited transfers of information.**
- c. The Compliance Plan adequately addresses Section 14:4-5.5(q) of the Standards.**

5. Recommendations

Liberty has no recommendations regarding the requirements of this provision.

T. Service Transfers

1. Statement of Applicable Requirements

Section 14:4-5.5(t) of the Standards provides that:

All transfers of services not prohibited by these standards shall be subject to the following provisions:

- 1. Transfers from the electric and/or gas public utility to a related competitive business segment of its public utility holding company of services produced, purchased or developed for sale on the open market by the electric and/or gas public utility will be priced at no less than the fair market value.*
- 2. Transfers from a related competitive business segment of the public utility holding company to the electric and/or gas public utility of services produced, purchased or developed for sale on the open market by the related competitive business segment of the public utility holding company shall be priced at no more than fair market value.*
- 3. Prices for services regulated by a state or Federal agency shall be deemed to be the fair market value.*
- 4. Services produced, purchased or developed for sale on the open market by the electric and/or gas public utility shall be provided to related competitive business segments of its public utility holding company and unaffiliated company(ies) on a nondiscriminatory basis, except as otherwise required or permitted by these standards or applicable law.*
- 5. Transfers of services not produced, purchased or developed for sale on the open market by the electric and/or gas public utility from the electric and/or gas public utility to related competitive business segments of its public utility holding company shall be priced at fully allocated cost.*
- 6. Transfers of services not produced, purchased or developed for sale on the open market by a regulated competitive business segment of the public utility holding company from that related competitive business segment of the public utility holding company to the electric and/or gas public utility shall be priced at the lower of fully allocated cost or fair market value.*

These provisions require that:

- “Open market” services the utility provides to an RCBS of the PUHC are priced at no less than fair market value and are provided on a nondiscriminatory basis (note that regulated services are at fair market value)
- “Open market” services an RCBS of the PUHC provides to the utility are priced at no more than fair market value (note that regulated services are at fair market value)
- “Non-open” market services the utility provides to an RCBS of the PUHC are priced at fully allocated cost
- “Non-open” market services an RCBS of the PUHC provides to the utility are priced at the lower of fully allocated cost or fair market value.

2. Summary of Audit Activities

The provision of and charging for common services falls among the topics addressed in Liberty's companion reporting of its examination of *Cost Allocations and Affiliate Relationships*.

U. Utility Asset Transfers

1. Statement of Applicable Requirements

Section 14:4-5.5(u) of the Standards provide that:

All transfers, leases, rentals, licenses, easements or other encumbrances of utility assets to a PUHC or related competitive business segments of a PUHC not prohibited by these standards shall be subject to the following pricing provisions, consistent with all other applicable Board rules:

- 1. Transfers, leases, rentals, licenses, easements or other encumbrances of utility assets from the electric and/or gas public utility to a related competitive business segment of its public utility holding company shall be recorded at fair market value or book value as determined by the Board.*
- 2. Transfers, leases, rentals, licenses, easements or other encumbrances of assets from a related competitive business segment of the public utility holding company to the electric and/or gas public utility shall be recorded at the lesser of book value or fair market value.*

These provisions address the pricing of assets transferred between affiliates, and generally require asymmetric pricing:

- Transfers from the utility to a PUHC RCBS are to be priced and recorded at fair market value or book value as determined by the Board.
- Transfers from a PUHC RCBS to the utility are to be priced at the *lesser* of book or fair market value.

2. Summary of Audit Activities

Liberty sought information from SJG regarding asset transfers, leases, rentals, easements and other encumbrances through data requests. Specifically, Liberty asked SJG to:

- Identify and describe each asset transfer from the regulated utility to each of the unregulated affiliates (and from each unregulated affiliate to the regulated utility) during the audit period
- List all asset leases and rentals between the regulated utilities and the unregulated affiliates of the parent/holding company
- List all licenses, easements, or other encumbrances of utility assets between the regulated utilities and the unregulated affiliates of the parent/holding company.

3. Findings

SJG did not have a procedure to address asset transfers during the audit period, but adopted one after commencement of this audit. SJG plans to make this new procedure a part of its Operating Procedures Manual. The new procedure addresses transfers, leases, rentals, license, easements, and other encumbrances of utility assets involving RCBSs. The procedure requires that such

transfers from an RCBS be made at the lesser of market or book value. Transfers to an RCBS must be recorded at the greater of these two values. The Manager of Regulatory Affairs must approve the value determinations, and may only do so after receipt of documentation assessing the book and market values of any property to be transferred.

The Company reported (in response to a data request asking for a list of all audit-period transfers) two asset transfers during the audit period. The first came in the context of the transfer of the appliance business from SJG to SJESP. This transfer has already been reviewed and approved by the BPU in GM02080609. In that proceeding, the BPU specifically considered a number of asset sale and lease agreements:

- An Agreement of Sale, which provided for the sale by SJG to SJESP of repair-service parts, personal computers, printers, cell phones, and small tools
- An Equipment Lease by SJG to SJESP covering motor vehicles, large tools, and an automated dispatch system, including computers and voice and data radios
- A Business Lease of 2,650 square feet of SJG space to SJESG in various buildings, including SJG's corporate and field offices.

The BPU accepted a stipulation providing for a transfer price of approximately \$620,000 for the assets transferred under the Agreement of Sale, and further providing for agreed to methods for calculating Equipment Lease and Business Lease rental rates. That stipulation also provided for the removal of the appliance business from SJG to SJESP for a one-time payment of \$1.5 million, to be applied to SJG's environmental Remediation Adjustment Clause. The BPU approved the transfer of the business, including these three agreements, as addressed in the stipulation, on July 29, 2004.

The only other affiliate asset transfer initially reported by SJG consisted of two laptop computers that SJI sold to SJG, in December 2002. The transfer took place at a book value of about \$500, on the SJI representation that the market value of the equipment was less than this amount.

SJG later reported that it entered on October 1, 2002 a month-to-month lease with its affiliate AirLogics, under which the latter leased air monitoring stations it used in the conduct of its business. The agreement provides for a rental rate of \$250 per unit up to and including all eight units. SJG reported that leases under this agreement ran from November 2002 through November 2003. Information that SJG later supplied indicated that the leases covered a shorter period.

Liberty sought the details of this transaction, and through data request responses learned that they included an audit-period sale of assets (not reported initially to Liberty) to affiliate, AirLogics. The assets appear to be the same ones leased by SJG to AirLogics earlier in the audit period. The assets consisted of an SJG air monitoring system (consisting of eight monitoring stations and related equipment), whose purchase the utility completed in 1998 at a total cost of about \$587,000. SJG used the system to conduct air monitoring during remediation activities at its manufactured-gas-plant sites. SJG used the system until early 2001, at which time it suspended further remediation activities.

The equipment requires special maintenance when not in use. Affiliate AirLogics provided this maintenance service from July 2001 through October 2002, for \$1,500 per month plus incidental,

out-of-pocket expenses. The lease of the equipment from SJG to AirLogics began under an October 1, 2002 lease, at which time maintenance expenses ceased. This agreement provided for a rental of \$250 per unit, or a maximum of \$2,000, should AirLogics require all eight available units. The lease allows month-to-month rentals of any or all eight units. The following table shows the AirLogics rental payments that SJG reported to Liberty. It includes the maintenance costs avoided for the remaining months of 2003 (March through November), during which time it appears that AirLogics did not use make the equipment available to one of its customers.

Table VII-11. Monitoring Equipment Rental Payments

Month	Units	Payment	AirLogics Maintenance
October 2002	8	\$2,000	
November 2002	8	\$2,000	
December 2002	4	\$1,000	
January 2003	4	\$1,000	
February 2003	4	\$1,000	
<i>Subtotal</i>		<i>\$7,000</i>	
Maintenance			\$13,500
Total		\$20,500	

SJG reported the maximum AirLogics revenue associated with its use of the leased equipment to be \$22,400. This amounts to roughly three times the lease payments by AirLogics. The sum, however falls reasonably close to what would have happened had it been able to charge SJG the \$1,500 per month for the last nine months of 2004, assuming the equipment went unused by an AirLogics customer during that period.

SJG sold the equipment to AirLogics for \$300,000 at the end of December 2003. SJG responded to a Liberty data request by noting that the market value of the equipment at the time of the sale was \$73,000 and that the book cost was would have been \$0, "if the system had been treated as a depreciable item," because it would have been fully depreciated by the time of sale. The manager of the AirLogics business prepared this estimate one month ago. He believes that creating a system from scratch would have cost AirLogics about \$330,000. This very recent estimate's relation to book value, in his judgment, more than supports the \$300,000 that AirLogics paid SJG in buying the equipment. The system that they sold was around 2002 and it went to a Wisconsin utility. That utility's system was one that AirLogics assembled new and specifically for that utility.

AirLogics rents or leases the equipment to its customers, and provides a variety of related services. The price varies by what specific services the customer wants, but a turnkey job produces about \$22,000 per month in gross revenues. AirLogics gross revenue for 2004 was \$1.9MM, and somewhat less in 2003. AirLogics has 40 stations: 32 acquired on its own and the 8 bought from SJG. AirLogics probably added only 8 units during the audit period. Its annual gross revenue expressed on a per 8-unit basis, therefore, was about \$380,000, which suggests a high utilization rate. During 2003 and 2004, AirLogics has had a maximum of 10 jobs going at any one time, and as few as 3 or 4.

The Company confirmed that there were no audit-period transfers of intellectual property between SJG and any affiliate.

The current Compliance Plan recites this provision, and notes that pricing responsibility for covered transfers lies with the Rates and Regulatory Affairs Department. This department issued an October 2004 memorandum noting that its approval would be required for all covered transactions.

SJI and its subsidiaries operate from a number of locations, which the following table summarizes.

Table VII-12. Office Facilities

Location	Square Feet		
	Gross	Rentable	Ratio
Headquarters: Folsom	64,450	58,633	90.97%
Divisions			
Atlantic; Pleasantville	15,588	14,713	94.39%
Glassboro; Glassboro	26,764	24,547	91.72%
Cumberland; Millville	19,886	18,141	91.22%
Cape May; Swainton	12,212	11,025	90.28%
Other			
Waterford	23,316	22,476	96.40%
Mckee City	10,812	10,271	95.00%
TOTAL	173,028	159,806	92.36%

The CAM sets forth the methods for determining the allocation of space costs. SJG bears initial responsibility for all building costs. SJG calculates the rentable space occupied by each affiliate. SJG does not segregate common and vacant space in order to assign to all occupying affiliates a pro rata share of these areas. SJG then determines the costs for the buildings. The last calculation for the Folsom Headquarters, for example, used 2003 costs. The cost categories include:

- Staffing (*e.g.*, janitorial)
- Custodial services
- Utilities
- Taxes
- Repair and maintenance
- Grounds and security
- Depreciation
- Property insurance
- Communications Infrastructure
- Copier and Paper
- Mailroom Services.

The cost categories do not include a return on investment in the building; *i.e.*, equity and debt issued by SJG to carry the building investment.

SJG adds the costs from all the applicable categories, and next determines an annual cost for each square foot of the building in question, on both a gross and a rentable basis. SJG then multiplies the rentable square footage occupied by each affiliate by the charge per rentable square foot.

The following table shows the portions of building costs that SJG would recover from affiliates for 2005 occupancy. Throughout the audit period, SJG made annual changes in the rental rates and periodic changes in the square footage occupied by affiliates.

Table VII-13. Proposed Affiliate Rents

Building	Rentable Sq. Ft.	Annual Cost	Charge
<i>Folsom</i>	58,633		\$24.09
SJI	4,909	\$118,257.82	
SJE	1,604	\$38,640.36	
Marina	220	\$5,299.80	
ASB	192	\$5,299.80	
<i>Pleasantville</i>	14,713		\$12.62
ASB	70	\$883.40	
<i>Glassboro</i>	24,547		\$11.60
ASB	2,109	\$24,464.40	
ASB	133	\$0.00	
<i>Swainton</i>			\$14.06
ASB	10	140.6	
<i>Millville</i>			\$15.27
ASB	66	\$1,007.82	
<i>Waterford</i>			\$8.72
ASB	70	610.4	
Total Charges		\$194,604.40	

SJG found it burdensome to collect the depreciation information necessary to determine how much the addition of a return component to rent would have cost, except in the case of the Folsom headquarters. That component would have added \$10.24 to the rents at Folsom for 2005. This addition would add about \$70,000 in additional rent to SJG from affiliates at Folsom.

SJG does not use the most recent year's actual costs for determining rental charges; there is a one-year lag. For example, SJG used actual 2003 costs to establish the 2005 rental rates shown above. This approach has the effect of requiring SJG to absorb a year's worth of cost inflation. The following table shows the rate of increase in year-over-year building costs for the headquarters building at Folsom.

Table VII-14. Three-Year Change in Space Costs

Facility	2000	2003	Change
<i>Folsom</i>	\$19.30	\$24.09	24.82%
<i>Cape May</i>	12.54	15.79	25.92%
<i>Cumberland</i>	11.92	16.62	39.43%
<i>Glassboro</i>	12.13	11.60	-4.37%
<i>McKee City</i>	10.98	10.98	0.00%
<i>Pleasantville</i>	13.48	12.62	-6.38%
<i>Waterford</i>	6.04	8.72	44.37%

No affiliate includes a charge for rent in the hourly charges or the allocations made of their costs for labor provided for the benefit of another related entity.

4. Conclusions

- a. Most of the material audit-period asset transfers initially reported by SJG came after BPU review and approval, upon consideration of the value and cost of the assets involved; Liberty did not test these transactions under Section 14:4-5.5(u).**
- b. SJG did not provide for structured controls over asset transfers during the audit period, but has recently adopted a procedure that does so.**
- c. SJG leased equipment to AirLogics and later sold the equipment to this affiliate without a prior examination of either book or market price.**

Neither the leasing nor the eventual sale of the equipment came after an appraisal, formal or otherwise, of market values. Accounting for the costs was at the specified lease and sale prices.

- d. SJG leased equipment to AirLogics and later sold the equipment to this affiliate at less than market price.**

Information available from AirLogics indicated that annual revenues expressed on a per-unit basis generate more than the price that SJG charged AirLogics for the equipment sold by the utility. AirLogics does provide related services that take people and expertise and it does take the risk of finding a customer for equipment in its inventory. It was prudent for SJG to sell the equipment, rather than retaining the burdens and risks of entering the business AirLogics was in as a means of recouping customer costs for the equipment. Nevertheless, a discount of 20 percent of the revenue that 8 units represents to AirLogics in just one year does not appear to represent fair value.

- e. SJG inappropriately bears a portion of the costs of unusable, empty, and common space that should be allocated to affiliates that occupy premises for which SJG pays.**

SJG is not in the real-estate business; it bears the initial costs of buildings merely as a convenience to all SJI entities. All entities, including SJG, should share in the costs of unusable, empty, and common space in proportion to their use of rentable space net of components such as these.

- f. SJG's use of dated costs to calculate its charges to affiliates for occupancy of premises inappropriately subsidizes non-SJG occupants.**

SJG should not be responsible for absorbing the increase in costs that results between the historical period used to base rents and the future period during which those rents are charged.

- g. SJG fails to include investment costs in its charges to affiliates for occupancy of premises for which SJG pays.**
- h. SJI fails to make charges for rent associated with the labor costs of employees whose time is directly charged or allocated to another affiliate.**
- i. The Compliance Plan adequately addresses Section 14:4-5.5(u) of the Standards.**

5. Recommendations

- 31. Prepare appraisals of market costs and calculations of book costs contemporaneously with the lease or sale of assets and record the correct cost at the time of transfer.**
- 32. Either reconcile rental costs charged to actual costs incurred after the fact, or use a reasonable factor to inflate dated costs to account for cost increases between the period use to determine rental charges and the period during which those rents are charged.**
- 33. Charge all entities, including SJG, for unusable, empty, and common space in proportion to their use of rentable space net of components such as these.**
- 34. Include investment costs in charges to affiliates for occupancy of premises for which SJG pays.**
- 35. Include an appropriate loader for rent in the labor costs of employees whose time is directly charged or allocated to another affiliate.**

VIII. Utility RCBS Financial Reports (Section 14:4-5.6(o))

A. Background

A utility operating an RCBS, which ASB was during most of the audit period must track:

- Total customers
- Total utility revenues
- Dedicated assets
- Carrying costs on dedicated assets
- Portion of shared assets allocated to competitive services
- Dedicated expenses incurred in the start-up, promotion and provision of service
- Fully allocated shared expenses
- Total margins, i.e., the difference between total revenues and total expenses
- Net revenues, i.e., the difference between total revenues and dedicated expenses
- Any such other item as the Board may determine.

Subsection (o) requires SJG to file an annual and a semi-annual report, using the information listed in (n) above, on the financial performance of each competitive product/service offered by the public utility or its RCBS.

B. Findings

Liberty asked for the reports filed to comply with this provision. SJG noted that it had pending with the BPU since August 16, 2002 (just before the start of the audit period) a petition seeking approval of the transfer of its ASB from the utility to a non-utility entity. This petition was approved on July 209, 2004, which is near the end of the audit period. Liberty's expectation therefore was that there would be semi-annual reports for covering each relevant six-month portion of the audit period; *i.e.*, the second half of calendar 2002, both halves of 2003 and the first half of 2004. SJG did make specific filings for what appears to be all of 2003 and for the first half of 2004. The Company did not provide a report for the second half of 2002, and it did not provide separate reports for each half of 2003. SJG noted, however, that it did provide information required by this provision in response to discovery in the docket addressing transfer of its ASB (Docket No. GM2080609) and in connection with an affiliates' audit.

The information that was supplied does not address a number of the information categories of subsection (n); *i.e.*, ASB assets, carrying charges on assets, shared asset allocations, or the difference between total revenues and dedicated expenses (although the last item is readily calculable from the information that was provided).

C. Conclusions

- SJG was not rigorous in making the required filings of ASB financial information during the audit period.**

SJG made some of the filings required, but missed several. The information filed also failed to include some required items of information. To some extent, SJG's failure to meet the

requirement was mitigated by the disclosures of information that it made in the context of the transfer of its ASB to a separate affiliate.

D. Recommendations

The BPU-approved transfer of the ASB moots the need for change, because the provisions of this provision of the standards no longer apply to SJG and because SJG has not other RCBS to which the provision would apply.

IX. Prior EDECA Audit Follow-Up

A. Background

In July 2000, the Board selected a firm that performed the audits of the state's three gas utilities, Elizabethtown Gas, South Jersey Gas and New Jersey Natural Gas. The firm completed these audits were completed under a compressed time schedule of three months. In 2002, the Board selected a different firm to conduct the next EDECA audits of the three New Jersey LDCs. The overall objective of the audits was to determine whether the utilities had complied with the Electric Discount and Energy Competition Act and the Board's rules, regulations and orders regarding competitive services. The auditors were required to determine whether there was strict separation and allocation of each utility's revenues, costs, assets, risks, and functions between the utility's electric or gas distribution operations and its related competitive business segments.

In their reports, the auditors provided an assessment of whether each utility had:

- Cross subsidies between the utility and its non-utility segments within a holding company structure
- A reasonable separation of utility and non-utility organizations based on the standards
- Any impact on the use of utility assets in the provision of non-safety related competitive services
- Any impact or effect on the utility's employees with particular interest in professional assignments to related competitive business segments.

In addition, the reports included an assessment as to whether the utility was unfairly affecting competitive services, and whether the utility could demonstrate compliance with the Act. The auditors were also required to render an opinion as to whether any other services offered by the companies was a competitive service, and to quantify, when possible, any amount unfairly allocated to the related competitive business segments.

Liberty reviewed the report from the last EDECA audit. The purpose of this review was to enable Liberty to interpret the approved recommendations as they apply to the utility as it now exists, taking into account new business relationships that may have solidified since the prior audit, changes in affiliates and their purposes (*e.g.*, removal of the appliance service business from the utility. Similarly, some of the pre-existing relationships among affiliated businesses have changed in the interim. As part of its review, Liberty sought to ascertain whether the scope of the recommendations has been affected by any new business relationships, and to ensure that steps are taken to implement the recommendations in all areas of the company as appropriate. Liberty's scope also included an independent analysis of whether the BPU should implement such recommendations.

B. Findings

The most recent SJG audit report identified 13 specific recommendations. Liberty examined progress in implementing them. The first area covered by those recommendations was affiliate transactions documentation and internal control, which produced the following recommendations:

- **Prior Audit Recommendation V.A.1.:** Create separate inter-company payable and receivable accounts for each SJI subsidiary and joint venture and record all inter-company transactions in these accounts.
- **Prior Audit Recommendation V.A.2.:** Develop a single monthly inter-company invoice summarizing all charges from one affiliate to another.
- **Prior Audit Recommendation V.A.3.:** Since the same person currently holds both positions, delineate the job responsibilities of the Assistant Vice President - Gas Supply & Off-System Sales of SJG and Vice President of SJRG in writing. Document how potential conflicts of interest in these positions will be avoided when the two companies transact business with each other.
- **Prior Audit Recommendation V.A.4.:** Adjust the officer appointments and/or board memberships of SJG, Millennium, and other subsidiaries to comply with Affiliate Standards or obtain permission for variances from the BPU.
- **Prior Audit Recommendation V.A.5.:** Resubmit the SJG Compliance Plan after incorporating the findings and conclusions of this report and file on an annual basis thereafter. Summarize the changes in the Compliance Plan at the beginning of the document for ease of comparison.

The Company reports the two recommendations about accounting and invoicing (V.A.1. and V.A.2.) as fully implemented as of September 2004. The Company provided charts of accounts and July 2004 general ledger postings. These documents show the existence and use of such accounts as required by the recommendation. The Company also provided August inter-company invoices showing compliance with the billing recommendation.

The Company also reports that it has made changes to comply with recommendation V.A.3. and V.A.4. addressing joint executive positions. The Company ended on April 29, 2004 the joint vice presidency role at SJG and SJR. The incumbent at the time of the recommendation has relinquished his title at SJR, as of April 29, 2004, to be replaced by another person, who holds no conflicting position at SJG. The Company also removed two utility officers from the executive committee of Millennium, in order to address recommendation V.A.4. The Company has also submitted annual Compliance Plans for 2003 and 2004.

The second area covered by those recommendations addressed cost allocations, which produced the following recommendations:

- **Prior Audit Recommendation V.B.1.:** Adopt an attributable cost basis for allocating the common costs of SJI departments and SJG departments providing shared services. Retain supporting work papers for these allocations.
- **Prior Audit Recommendation V.B.2.:** Make necessary adjustments to all cost allocations affected by the organizational misalignment of shared corporate services.

The Company has made substantial changes to the cost allocation manual. Liberty performed its own detailed examination of cost allocations and supporting procedures and work papers. Liberty's companion reporting on its examination of *Cost Allocations and Affiliate Relationships* provides the results of that examination, which subsumes the recommendation being addressed here. SJI also moved a number of services from SJG to SJI; *i.e.*, government relations, internal

audit, and planning and forecasting. These changes go a long way toward the realignment that the prior auditor recommended. The changes do not result in the formation of a service company, but. Liberty did not find the creation of such an entity to be necessary or appropriate for SJI.

The third area covered by those recommendations addressed the appliance service business, which produced the following recommendations:

- **Prior Audit Recommendation V.C.1.:** Track assets and costs as specifically identified in the Affiliate Standards for all affiliates and related competitive business segments.
- **Prior Audit Recommendation V.C.2.:** Prohibit appliance service technicians from performing utility work and prohibit utility technicians from performing appliance repair service except in cases of emergency.
- **Prior Audit Recommendation V.C.3.:** Prohibit the ASB from using the utility's database from future targeted marketing.

The Board's July 29, 2004 Order in Docket Number GM02080609 generally addressed these recommendations. Moreover, Liberty's work in examining cost allocations *Cost Allocations and Affiliate Relationships* and its work in examining the discrimination and information disclosure requirements of the Affiliate Standards (see Chapters V. and VI. of this report) were intended to validate that performance complied with standards including those set forth in recommendations V.C.1 and V.C.3.

The fourth area covered by those recommendations addressed Millennium, which produced the following recommendations:

- **Prior Audit Recommendation V.D.1.:** Modify the agreement between Millennium and SJG to price meter reading services to recover no more than Millennium's fully allocated costs, including a regulated return on SJI's investment.
- **Prior Audit Recommendation V.D.2.:** Delete provisions in the Meter Reading Services Agreement dated December 1, 2001 between SJG and Millennium, which permit Millennium to compel SJG to take ownership of certain meter reading equipment.

This issue was part of the settlement reached in SJG's recent rate case, which the Board's Order of July 8, 2004 in Docket Numbers GR03080683 and GR00050295 reflects. The Company has agreed to bid the contract at the end of 2006.

The fifth area covered by those recommendations addressed SJE, which produced the following recommendations:

- **Prior Audit Recommendation V.E.1.:** Prohibit any direct or indirect compensation of SJG employees for marketing, selling, or promoting SJE products and services.

SJG issued on August 31, 2004 a memorandum instructing SJE not to compensate SJG employees for residential leads.

C. Conclusions

- a. The Company has satisfactorily implemented the five affiliate transactions documentation and internal control recommendations (V.A.1 through V.A.5) from the prior EDECA audit.**

Liberty's audit addressed affiliate transactions and controls in substantial detail. We found compliance with the prior audit's recommendations, but invite attention to the earlier portions of this report for a discussion of our findings, conclusions, and recommendations on these subjects for the current audit period and for the future.

- b. The Company has made substantial changes to its cost allocations, in order to address recommendations V.B.1. and V.B.2. of the prior EDECA audit.**

Liberty's findings, conclusions, and recommendations about cost allocations are set forth in Liberty's companion reporting on its examination of *Cost Allocations and Affiliate Relationships*.

- c. SJI has made substantial reorganizations intended to place at the holding company level many services that it provides in common for utility and non-utility operations.**

Liberty does not consider the establishment of a service company to be necessary or appropriate for SJI. This conclusion results from all four major facets of Liberty's work at SJI/SJG.

- d. The Board's Order adopting a stipulation approving the transfer of SJG's appliance service business to affiliate SJESP generally addresses recommendations V.C.1. through V.C.3. of the prior EDECA audit.**

Liberty's companion reporting on its examination of *Cost Allocations and Affiliate Relationships* and the previous chapters of this report provide further details about the cost allocation, information disclosure, and discrimination requirements of the Affiliate Standards requirements addressed in recommendations V.C.1. and V.C.3. of the prior EDECA audit.

- e. The Board's Order adopting a stipulation in SJG's recent rate case provides for an appropriate resolution of the Millennium recommendations (V.D.1. and V.D.2.) made in the prior EDECA audit.**

- f. SJE has ceased the practice of compensating SJG employees for referrals of residential customers.**

D. Recommendations

Liberty has no recommendations concerning follow-up to the prior EDECA audit. However, Liberty's companion reporting on its examination of *Cost Allocations and Affiliate Relationships* and the preceding chapters of this report address related organizational, cost allocation, and other EDECA issues addressed as part of Liberty's work.